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S. HRG. 105-309

**THE PUBLIC UTILITY HOLDING COMPANY ACT
OF 1997—S. 621**

HEARING
BEFORE THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDRED FIFTH CONGRESS
FIRST SESSION
ON
S. 621

TO REPEAL THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, TO
ENACT THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1997, AND
FOR OTHER PURPOSES

APRIL 29, 1997

Printed for the use of the Committee on Banking, Housing, and Urban Affairs



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THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1997—S. 621

TUESDAY, APRIL 29, 1997

**U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.**

The Committee met at 9:34 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Alfonse M. D'Amato (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN ALFONSE M. D'AMATO

The CHAIRMAN. The Committee will come to order.

I will submit my full statement for the record so that we can hear from our witnesses. The first is Senator Murkowski, Chairman of the Energy Committee.

Before we hear from Senator Murkowski, I would like to note that the legislation we are considering is the Public Utility Holding Company Act; known as PUHCA—"puka" or "pooka"—depending on where you come from and not to be confused with PURPA.

[Laughter.]

Today we will be looking at S. 621, the Public Utility Holding Company Act of 1997. This bill is the same bipartisan legislation this Committee reported to the last Congress.

The bill would repeal PUHCA, eliminating the SEC's role as the primary regulator of the 15 registered public utility holding companies, giving that regulatory authority to the States and the FERC.

Let me say, as both Chairman and Ranking Member of the Senate Energy Committee, Senator Murkowski and Senator Johnston, testified last year, the repeal is necessary "to streamline regulation, promote competition, and protect utility customers." I would like to thank Senator Murkowski for appearing here today and for his untiring leadership.

I believe that this legislation would improve consumer protection and make the energy industry more competitive.

Let me point to something else. When you get a regulator, in this case the SEC, indicating they are supportive of legislation which reduces their authority, then you know that the statute has long outlived its usefulness and the purposes for which it was initially intended. Such is the case with PUHCA, and so has been the case here.

Let me again commend Senator Murkowski for his leadership, and I thank the cosponsors of this bill: Senator Dodd, Senator Sarbanes, Senator Gramm, Senator Shelby, Senator Mack, Senator Faircloth, and Senator Allard.

This bill has broad bipartisan support from this Committee and it's my intent to move to markup and to the Floor as soon as leadership can give us time.

Senator Murkowski.

**OPENING STATEMENT OF FRANK H. MURKOWSKI
A U.S. SENATOR FROM THE STATE OF ALASKA AND
CHAIRMAN OF THE SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES**

Senator MURKOWSKI. Thank you very much, Mr. Chairman. I appreciate the opportunity to appear before the Banking Committee today, and you as Chairman.

I'm not sure if it's "pooca" or "pewka." I suppose it might be somewhere in between.

Let me also thank you for having reported this bill out of your Committee last year. It is my understanding that this is the same bill that has been resubmitted in the 105th Congress.

Basically, my testimony leads to the repeal of PUHCA.

The CHAIRMAN. See, I got you doing it.

Senator MURKOWSKI. You got me already.

[Laughter.]

We used to do the "Origone"/"Orgen." Remember that?

The CHAIRMAN. Yes.

Senator MURKOWSKI. Anyway, the repeal of PUHCA is the right thing to do. Repeal is pro-consumer and it's pro-competition.

As you are aware, the electric power industry is undergoing dramatic change, and is seeking ways to become even more competitive. If there is to be robust competition, I think we have to get rid of unnecessary Federal constraints that prevent companies from adapting quickly and from responding flexibly to the changing market circumstances. This is exactly what PUHCA prevents and why PUHCA must go.

When we talk about PUHCA repeal, we think first about how it restricts the 15 registered electric and gas utility holding companies. But that is just a small part of the story. PUHCA also limits the competitive activities of hundreds of PUHCA-exempt utilities and the numerous non-utilities, all of whom want to participate fully in the electric power market. These companies won't take a variety of pro-competitive actions out of fear of becoming classified as a registered holding company. To them it's not worth getting tangled in PUHCA's sticky web of restrictions and requirements.

Mr. Chairman, some have claimed that this legislation will create a "regulatory gap" that will allow consumers to be harmed. That is simply not true. Over the past 60 years, we have seen a comprehensive State-Federal regulatory system that has been developed to protect consumers. We have the FERC and we have State utility commissions, plenty of oversight.

As I am sure you will agree, the legislation does not, nor is it intended to, allow utilities to evade appropriate regulation at the Federal and State level. But, having said that, like you, I am certainly open to improvements to the bill's consumer protection provisions as long as they are within the context of the legislation.

Mr. Chairman, just as you did last year, today you may hear from some that Congress should act on this bill only as part of a

so-called "comprehensive" legislation to restructure the entire electric power industry. That's a pretty big order. You may also hear from others who want to use this bill as a vehicle to move highly controversial matters, such as Federal pre-emption of the States, federally-ordered retail wheeling, or mandatory utility breakup. I would urge you to reject these calls. This legislation can, and should, proceed on a stand-alone basis. Otherwise, we're not going to get it done.

The CHAIRMAN. Mr. Chairman, let me ask you as an authority who has been working in this area for many, many years, what you're saying is that there really are two views. One says, don't do anything unless you do everything. Don't make even the reforms that we agree are good and necessary because we want everything to be handled in a comprehensive energy package. Right?

Senator MURKOWSKI. That is correct.

The CHAIRMAN. The other view is held by people who, notwithstanding the merits of the bill, want to attach their pet project to the legislation. Even where there is no consensus on the issues they raise, they would rather have no reform than have to give up their issues.

Senator MURKOWSKI. Or they see something moving and they want to throw something on it that wouldn't move otherwise.

The CHAIRMAN. I think it's important to get that on the record. It is one thing for people to oppose the legislation on a policy level or because they think it lacks necessary provisions, however, opposing the legislation because it's not loaded with people's pet projects will simply lead to us doing nothing.

Senator MURKOWSKI. The Chairman is correct. We have been pursuing deregulation of the electric industry on the theory that the industry isn't broke. We're not there to fix it, but we're there to make it more competitive and reduce costs, if we can. We're going very slow. We're going through a workshop process to develop legislation, as opposed to just dumping in legislation because it's a very complex industry.

I would urge, therefore, that there not be a linkage to action on PUHCA repeal with other legislation. Furthermore, Mr. Chairman, pro-consumer PUHCA reform should not be held "hostage" to unacceptable proposals. I think each should rise on its own merits.

As you are aware, the Energy Committee, as I have indicated, is holding a comprehensive series of hearings and workshops on competitive change in the electric industry. Through this process, the Energy Committee will determine what changes, if any—and I highlight, if any—are necessary to the utility laws that are jurisdictional to our own committee. The Energy Committee will continue this process. We will legislate if and when we are convinced that legislation will benefit the consumer, as will PUHCA repeal.

In conclusion, Mr. Chairman, PUHCA is now in its 60th year. It was designed to cure the problems of a now long-gone, Depression-era industry structure. Having done its job, it's now time to retire PUHCA. I look forward to working with you and other Members of the Committee when you take this matter up to the Floor.

Let me just conclude by making a couple of points relative to the pros and cons and the case for PUHCA.

The suggestion and the concern has been expressed that PUHCA prevents mega-mergers. The argument that PUHCA prevents utility mega-mergers which will take us back to the so-called bad old days when just a few utilities dominated the market is certainly not the case now because before a merger can take place, both the FERC and State public utility commissioners must approve it. If they object, a merger will not occur or the regulators can require the utility to make changes before they approve the merger.

Some suggest that PUHCA ensures and mandates the necessity of regulation and the argument, the repeal of PUHCA will allow multi-state utilities to invade necessary State regulation. They will be able to do something in one State and pass those costs on to the consumers of another State. That is not true. This is not a PUHCA issue. This is a State regulatory issue. This can occur now, if a State commission is not vigilant or is unwilling to do its job for the hundreds of PUHCA-exempt utilities.

This legislation affirmatively gives the State public utility commissioners the ability to properly regulate and protect consumers. It gives them the access to utility books, records necessary to do the job of rulemaking, and the willingness of State public commissioners to do their job is strictly, obviously, up to them and not a mandate or a dictate from Congress.

The last point is that PUHCA prevents risky utility diversification. The issue has been suggested that PUHCA prevents registered holding companies from diversifying outside of their service territory and outside of the utility business. PUHCA repeal would allow utilities to expand and diversify and thereby put their customers at risk if the venture fails.

The response to that, again, is that PUHCA is a restriction on the 13 registered electric holding companies, but not on the several hundred PUHCA-exempt electric utilities. State public utility commissions today face this problem for the several hundred PUHCA-exempt electric utilities. They address this problem through the normal rate-making process, which this legislation enhances and aids by giving State commissions expanded access to utility books and records.

That's the case as I see it, Mr. Chairman, and I thank you for the opportunity to be with you today. I would be happy to respond to any questions, and I would encourage the Committee to move on this as expeditiously as possible because there is a significant need for it.

The CHAIRMAN. I'm just going to ask one question, Senator.

Is it your belief that the repeal and the modification of PUHCA, as we have outlined in this bill, would help consumers and result in lower energy cost?

Senator MURKOWSKI. It would help consumers, it would provide more competitiveness, and it would result ultimately in lower energy costs and more efficiency in the industry.

The CHAIRMAN. I think that should be, and is, everyone's goal. I want to thank you for your testimony.

Senator Reed, do you have any questions or statements that you would like to make at this time?

OPENING STATEMENT OF SENATOR JACK REED

Senator REED. Mr. Chairman, I would just like to commend you for holding this hearing, and to commend Chairman Murkowski for his efforts in this regard.

As Senator Murkowski pointed out, this is a 60-year-old statute that deserves review and analysis, which is particularly appropriate at this time as the energy industry in the United States is being deregulated.

My home State of Rhode Island is leading the way in trying to deregulate its energy policy, so I look forward to working with you, Mr. Chairman, and the other Members on this issue.

Thank you very much.

The CHAIRMAN. Thank you, Senator. We have just been joined by Senator Dodd, who is a cosponsor of this legislation.

Senator Dodd.

OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Thank you, Mr. Chairman. Thank you, Frank, for being here. Good morning.

Senator MURKOWSKI. Good morning.

Senator DODD. I will ask, Mr. Chairman, for consent to be able to include my prepared statement in the record.

I want to thank you for holding this hearing. We got pretty close on this last year. As you know, we passed it through our Committee unanimously—I think it was on a voice vote before the Senate, as I recall. Ultimately, it got bogged down in the House.

This is absolutely essential if we're going to get more competition in the energy field. I think it protects consumers very, very well and gets rid of some unnecessary regulations.

My constituents often ask me, what are the two issues that you are involved in? I say, PUHCA and FEDUPHA.

[Laughter.]

This really throws them for a loop.

[Laughter.]

Senator MURKOWSKI. Ruins their whole afternoon.

Senator DODD. You can spend all afternoon with those acronyms around here.

At least, obviously, some people in the room are interested in this issue. This may be the whole universe of interest out here, by the way.

The CHAIRMAN. Probably.

[Laughter.]

Senator DODD. I go home and hold a town meeting to talk about PUHCA, and I can tell you, I actually see their eyes glaze over on this issue.

[Laughter.]

But it's critically important, obviously. In Senator Reed's State, Rhode Island, they have been tremendously successful on deregulating and creating real competition in the energy field. Massachusetts, I know is working on it. We have a bill in the Connecticut legislature to move on this in a similar vein.

Exciting things are happening in this area. I'm glad we can move on this and I hope we can do it fairly quickly, Mr. Chairman.

The CHAIRMAN. I thank you very much. Senator Murkowski, we thank you.

Senator MURKOWSKI. You're welcome.

The CHAIRMAN. Again, it is my intent to move this legislation quickly, barring any unforeseen developments or new areas that have not yet been pointed out, and call for a markup and move to the Floor.

Senator MURKOWSKI. Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator MURKOWSKI. I wish you all a good day. Thank you very much, gentlemen.

The CHAIRMAN. We will now call our second panel: Isaac Hunt, Commissioner of the U.S. Securities and Exchange Commission; Susan Tomasky, General Counsel of the Federal Energy Regulatory Commission; Robert Gee, Commissioner, Public Utility Commission of Texas.

Good morning. It's good to see you all. Commissioner Hunt, it's always great to see you.

Mr. HUNT. It's nice to see you, Senator.

The CHAIRMAN. We look forward to your testimony.

OPENING STATEMENT OF ISAAC C. HUNT, JR., COMMISSIONER U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. HUNT. Chairman D'Amato, Members of the Committee, good morning. I am Commissioner Isaac Hunt of the U.S. Securities and Exchange Commission. I appreciate very much the opportunity to testify before you this morning on behalf of the SEC regarding Senate Bill 621, which would repeal the Public Utility Holding Company Act of 1935, and replace it with a less pervasive framework for regulation of public utility holding companies. The legislation is designed to eliminate duplicative and overly burdensome regulation imposed on holding companies registered under the 1935 Act, while preserving important consumer protections reflected in certain provisions of that Act. The SEC shares the concerns that the bill addresses and strongly supports the goals that it seeks to achieve.

In 1935, Congress enacted the Public Utility Holding Company Act to correct the abusive, harmful practices that had become common among public utility holding companies in the United States during the early part of the century. By owning controlling interests in utility companies around the country, public utility holding companies were able to frustrate the efforts of the State regulators. These companies also harmed investors and energy consumers by inadequately disclosing their financial positions, engaging in unsound accounting practices, issuing excessive debt, and engaging in transactions detrimental to their utility subsidiaries.

The tools of Government were inadequate in 1935 to deal with abuses by public utility holding companies. State utility regulation at that time was in its infancy and its growth was hindered by judicial interpretations limiting its ability to regulate electric and gas utilities to respond to these abuses.

In the Public Utility Holding Company Act of 1935, Congress carefully crafted a comprehensive statute, effectively dismantling a large portion of the utility holding companies then in existence. Holding companies which did not fit within several narrow exemp-

tive criteria were required to register with the SEC and submit financial activities and other business transactions to prior SEC review. Acquisitions of utility securities and assets were often subject to scrutiny under the standards of that statute.

In the years that have passed since the 1935 Act was enacted, the holding company landscape has changed dramatically. In the summer of 1994, therefore, in light of regulatory and other changes taking place within the utility industry, Chairman Arthur Levitt directed the SEC staff, under the guidance of then-Commissioner Richard Roberts, to undertake a comprehensive study of the 1935 Act. The purpose of the study was to determine the aspects of regulation under the statute which were still needed and those that should be revised or eliminated.

The Commission solicited the views of all interested parties and received back thousands of pages of comments from the utility industry, consumer groups, trade associations, investment banks, rating agencies, and economists, as well as local, State, and Federal regulators.

The study culminated in a June 1995 report of the SEC staff. That report notes that numerous developments in State and Federal regulation and in energy technology support changing significantly the way utility holding companies are regulated. The report concluded that the 1935 Act had accomplished its basic purpose and that many of its provisions now only duplicate other State or Federal regulation or are no longer necessary to prevent recurrence of past abuses.

On the basis of the staff report, the SEC recommended that Congress consider three legislative options. The SEC's preferred option is a conditional repeal of the 1935 Act. Under that option, Congress would repeal the 1935 Act, but at the same time provide authority relating to affiliate transactions, audits, and access to books and records to State regulators and to the Federal Energy Regulatory Commission.

Senate Bill 621, like its predecessor, S. 1317, incorporates the key elements of the Commission's recommendations regarding the future regulation of public utility holding companies.

We believe the bill's protections for consumers could be enhanced if it were amended to provide the FERC with broader authority over transactions among affiliated companies and registered holding company systems. In our view, the potential exists, absent this type of Federal oversight, for subsidization of non-utility activities at the expense of the utility customers. As a result of this, the SEC recommends that the FERC have discretion to regulate affiliate transactions to whatever extent necessary to prevent this potential abuse, including in appropriate cases the jurisdiction to require prior approval and review of affiliate contracts.

The SEC believes that Senate Bill 621 represents much needed reform. The bill makes significant progress toward the goal of reducing unnecessary regulatory burdens on registered holding companies and, at the same time, it preserves those parts of the 1935 Act that are still needed to protect consumers from harm.

Mr. Chairman, the Commission strongly supports the enactment of this bill. I will be pleased to answer your questions.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Commissioner.
 The General Counsel for the Federal Energy Regulatory Commission, FERC, Susan Tomasky.
 Susan, thank you.

**OPENING STATEMENT OF SUSAN TOMASKY
 GENERAL COUNSEL
 FEDERAL ENERGY REGULATORY COMMISSION**

Ms. TOMASKY. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Committee, it's a pleasure to be here this morning to discuss S. 621, the Public Utility Holding Company Act of 1997.

Under current law, there are two major Federal statutes affecting electric utilities—the Holding Company Act, which is administered by the U.S. Securities and Exchange Commission, and the Federal Power Act, which is administered by our agency, the Federal Energy Regulatory Commission. Both were enacted as part of the same legislation in 1935, to curb widespread financial abuses which harmed electric utility investors and electricity consumers. While there is overlap in the matters addressed by these Acts, they each have different public interest objectives. The areas of overlap are thoroughly described in testimony submitted last year to this Committee by the Chair of the FERC, Elizabeth Moler, and I won't repeat that here.

Last year, in her testimony, Chair Moler did indicate that the FERC would defer to the expertise of the SEC as to whether the Holding Company Act should be repealed. The SEC's substantial review of the ongoing need for the Act, which is described in the SEC's June 1995 report, led that agency to ask Congress to conditionally repeal the Act and enact certain rate-payer safeguards in its place. We agree with the fundamental premise of the SEC's report, that is, that rate regulation at the Federal and State level has become the primary means of ensuring rate-payer protection against potential abuse of monopoly power by utilities that are part of holding company systems.

This is a time of enormous change for the electric utility industry. It is entirely appropriate for Congress to now reexamine the Holding Company Act and to eliminate unnecessary restrictions on corporate activity.

At the same time, as utilities diversify and enter competitive businesses, the need to protect adequately against affiliate abuse becomes all the more significant. Rate-payers need to be protected against unfair charges for goods and services provided to utilities by their unregulated affiliates. Proper cost allocation is also essential, both to ensure that rate-payers do not bear the costs of non-utility business activity and to ensure that utilities do not enjoy an unfair advantage in the competitive markets by virtue of improper rate-payer subsidies.

We believe that the Holding Company Act can be repealed without jeopardizing consumer protection, so long as certain issues are adequately addressed.

Mr. Chairman, since the hearing on this matter you held last year, your staff has worked cooperatively with staff of the FERC to fashion provisions which address those specific concerns we had

with the legislation as introduced. That effort was very productive from our perspective, and has resulted in suggested changes which were incorporated into the Committee-reported bill last year and that are fully reflected in S. 621, the bill before the Committee today.

We believe that the provisions of S. 621, providing the FERC access to books and records, are sufficient to ensure that we can do our job as regulators. Among the modifications to last year's bill are provisions which ensure that the FERC has access to books and records with respect to all public utility holding companies. These modifications are central to our conclusion that rate-payers can continue to be protected if the Holding Company Act is repealed.

We also believe that other provisions have been properly clarified to address our previous concerns. We have no objection to the requirement under Section 7 that we exempt certain holding companies from the books and records requirement. We defer to the State commissions on the adequacy of the provision, assuring them access to books and records of holding companies and their affiliates.

On this basis, we believe that if Congress follows the SEC's recommendation to repeal the Holding Company Act, S. 621 is the most appropriate vehicle for doing so without impairing rate-payer protection.

I thank you for your attention and I would be happy to answer your questions.

The CHAIRMAN. Thank you very much.

Mr. Gee is the Commissioner of public utilities of the Great State of Texas, and he's testifying on behalf of the National Association of Regulatory Utility Commissioners.

Mr. Gee, it's good to see you again.

**OPENING STATEMENT OF ROBERT W. GEE
COMMISSIONER, PUBLIC UTILITY COMMISSION OF TEXAS
ON BEHALF OF THE NATIONAL ASSOCIATION OF
REGULATORY UTILITY COMMISSIONERS**

Mr. GEE. Thank you, Mr. Chairman, Members of the Committee. I appreciate the opportunity to appear before you today once again to testify on PUHCA reform. My name is Robert Gee. I am a Commissioner from the Public Utility Commission of Texas. I also chair the Electricity Committee of the National Association of Regulatory Utility Commissioners, commonly known as NARUC.

Our association represents the State officials of the 50 States who are charged with the duty of regulating retail rates and services of electric and gas utilities.

The June 1995 report of the Securities and Exchange Commission, which we heard from previously, recommended "conditional repeal" of PUHCA, and recognizes the importance of States' oversight of these types of utility systems. While the SEC's legislative recommendations are certainly consistent with many suggestions made by the NARUC, the scope of the SEC recommendations are not. The NARUC favors changes to PUHCA only if made in conjunction with comprehensive revisions to the Federal Power Act that enhance State restructuring activities.

The NARUC appreciates, Mr. Chairman, your efforts to affirm the importance of State oversight of multi-state utility holding com-

panies. Our association believes that S. 621 moves in a positive direction toward rationalizing regulatory oversight in an increasingly competitive market. Importantly, however, the competitive market needs to function fairly and effectively before repealing the 1935 Act, so that no market participant is provided an unfair competitive advantage by virtue of its corporate structure.

Our State's primary concerns with regard to any PUHCA reform include the following: ensuring that the authority of the States to regulate utility holding companies is not pre-empted or restricted; establishing a transition period which would provide States with the time necessary to obtain requisite authorities to oversee utility holding companies; clarifying State authority over affiliate transactions of multi-state holding companies, including also non-power transactions between affiliates; providing for an unequivocal State right of access to all books and records, wherever located, for the effective discharge of State oversight responsibilities; and authorizing the FERC and States to audit and investigate companies in a registered holding company system.

Our association is very concerned about the recent trend toward mergers and believes that any legislation must recognize that regulation should be reduced only as competition becomes effective at preventing monopoly abuses and allowing pro-competitive change and availability of customer choice. Accordingly, the NARUC supports the establishment of a mechanism which would maintain the effective State and Federal regulation against abusive holding company practices that could place undue market power in the hands of multi-state holding companies and could harm the development of competition.

While the NARUC believes PUHCA reform legislation should not pass separately from legislation to amend the Federal electric utility laws in other respects, the association would be remiss not to suggest ways to further improve S. 621, should it ultimately proceed to a Committee vote. S. 621 helps to ensure the States' ability to access multi-state holding company books and records, to audit multi-state holding companies, and regulate affiliate transactions within a holding company system.

The NARUC commends the Chairman for including in this year's bill provisions added into last year's bill by the Committee that addressed the enforcement of books and records accessibility, which are similar to the approaches contained in the Energy Policy Act of 1992 and the Telecommunications Act of 1996. Because the relevant provisions of both those Acts, however, would be repealed if S. 621 were enacted in its current form, such an enforcement provision should be clarified to ensure the continued right of State commissions to obtain access to books and records of exempt wholesale generators and exempt telecommunications companies.

Prior to the adoption of S. 621 by this Committee, the NARUC also requests clarification of the exemption provisions. It would be extremely helpful if the authority given to the FERC to terminate a grandfathered utility exemption under the 1935 Act were revised in order to ensure that all utility holding companies are subject to similar regulatory treatment regardless of corporate form. Also, the NARUC would support clarifying that the FERC's authority to exempt any person or transaction does not translate into an ability

to exempt utility companies from State regulation under this legislation, including the ability to obtain access to books and records.

While the NARUC appreciates the Committee's response to our concerns during last year's debate by changing the effective date from 12 to 18 months, in our view, a transition period of 2 years, at a minimum, would be more appropriate to enable State commissions to acquire such enabling authorities necessary for meaningful oversight of registered holding companies.

For instance, in my State of Texas, as well as other States, the legislature meets just once every 2 years. In fact——

The CHAIRMAN. That's a good policy.

[Laughter.]

Mr. GEE. We believe so, yes, sir.

The CHAIRMAN. As a matter of fact, we ought to try that in a national referendum. It would probably pass overwhelmingly.

Maybe even for Congress.

[Laughter.]

Senator DODD. They would suggest we never meet.

[Laughter.]

The CHAIRMAN. The Texas legislature meets for only 150 days, is that right?

Mr. GEE. That's correct, sir. About 5 months every 2 years.

Senator GRAMM. That's just too long.

The CHAIRMAN. Yes.

[Laughter.]

Then they go out.

Mr. GEE. Unless there's a special session called by the Governor.

The CHAIRMAN. That's not bad. Go ahead.

Mr. GEE. In fact, our legislature——

The CHAIRMAN. At least we got some productive suggestions out of this hearing.

[Laughter.]

Mr. GEE. This wasn't necessarily the focus of my presentation.

[Laughter.]

But I'm glad to provide helpful advice in any respect.

[Laughter.]

Our legislature is meeting this year. When the Texas legislature meets, it traditionally does so, as I indicated, for just 5 months at the beginning of every other year. Therefore, if PUHCA repeal were enacted into law this year, my public utility commission would need to assess whether it required additional multi-state utility oversight authority and, if so, would need an opportunity to seek such authority from our legislature. However, because our commission would be unable to secure such authority until 1999, during such time we could be at risk of being without adequate safeguards to protect consumers from cross-subsidization risks and diversification abuses. Further, in other jurisdictions, registered holding companies could be free to restructure or to diversify into other lines of businesses, conceivably absent any State or Federal oversight.

As we continue to advance and move toward a more competitive electric market, Mr. Chairman, PUHCA may indeed become less relevant. However, in the absence of a truly competitive market, we must carefully assess what safeguards are necessary to protect consumers from potential abusive practices by holding companies.

We must also evaluate whether such changes are consistent with the pro-competitive changes in the electric market and do not discourage greater competition in the marketplace. For these reasons, the NARUC believes reform of PUHCA must be considered in conjunction with those changes to the Federal Power Act that support State and FERC efforts to provide utility consumers with options in emerging competitive markets.

That completes my remarks, Mr. Chairman. I thank you.

The CHAIRMAN. Thank you, Mr. Gee.

Let me say that we will continue to work with you. While it is my intent to schedule a markup sooner rather than later, we want to address your concerns since we want the State regulators to have the ability, particularly in the area of cross-subsidization, to monitor companies and set rates.

We have been working together and have come a long way, so if you have any additional concerns, I would hope that we could have our staffs meet to work them out.

Mr. GEE. Thank you, Mr. Chairman. We look forward to working with you and your staff.

The CHAIRMAN. Senator Bryan.

OPENING STATEMENT OF SENATOR RICHARD H. BRYAN

Senator BRYAN. Thank you very much, Mr. Chairman. Is this an appropriate time for me to make a brief opening statement?

The CHAIRMAN. Yes.

Senator BRYAN. I thank the Chair. Mr. Chairman, as you know, I opposed this legislation during the last session of Congress and I would expect to oppose it in this session as well. My opposition to the legislation which would repeal PUHCA is not an endorsement of the current Act. Clearly, PUHCA, as currently constituted, is not the most effective way to accomplish the goals of regulating the industry.

I can understand the SEC's unhappiness with its duty to enforce and administer PUHCA, and I can also understand the anxiousness to be freed from its regulatory burden by those utilities that are currently regulated by PUHCA. Unfortunately, however, in my judgment, even with the shortcomings of PUHCA, we are at this point better with PUHCA than without it.

I favor, as Mr. Gee indicates, a PUHCA that is part of an overall deregulation piece of legislation, so that we do not have the stand-alone PUHCA repeal as is currently proposed in this legislation.

My primary interest in the current discussions of electricity restructuring is to protect the consumer. It seems to me, quite simply, there are two options. One option is the current practice, which is regulated monopoly. The other is true competition. In my judgment, the legislation being considered today accomplishes neither. In essence, it creates the potential for unregulated monopolies, perhaps the worst situation from the consumer point of view.

I have great confidence in the utility regulators in my own State to regulate intra-state operations, but I see no way in which they can effectively regulate inter-state and, indeed, even international activities with the kind of holding companies that are currently regulated by PUHCA.

I'm afraid the legislation we are considering today is a case of putting the cart before the horse. As imperfect and out-of-date as PUHCA may be, it simply does not appear prudent to allow these large holding companies to be free from regulation, in effect, encouraging both the diversification into other industries and further consolidation of the electricity industry, before we have some assurance that competition has been achieved.

I would acknowledge that much has changed in the electricity industry since the enactment of PUHCA in 1935, but there are still some things which have not. The unregulated monopolies' capability of abusing consumers is something that we still see. I would urge the Committee to act very cautiously before moving forward with this legislation.

Mr. Chairman, if I may, I might note that Senator Bumpers, who is now the Ranking Member of the Senate Energy Committee, has written a letter expressing his views on this legislation. I would ask unanimous consent that his letter be made a part of the record.

The CHAIRMAN. So ordered.

Senator BRYAN. I thank the Chair and would simply point out that he also raises some of the concerns which I have just raised. He points out the fact that practically every organization representing consumers, including the Consumer Federation of America, the National Association of State Utility Consumer Advocates, the American Public Power Association, the National Rural Electric Cooperative Association, as well as the National Association of Regulatory Utility Commissioners, opposes the passage of stand-alone PUHCA repeal.

I thank you for making that letter a part of the record and for the opportunity to express my views.

The CHAIRMAN. Thank you, Senator.

Senator Gramm.

OPENING STATEMENT OF SENATOR PHIL GRAMM

Senator GRAMM. Thank you, Mr. Chairman. Let me first say that the Public Utility Holding Company Act is the only part of the deregulation puzzle that's under the jurisdiction of this Committee. I believe the generation of electric power is not now, nor has it ever been, a natural monopoly. The benefits to the American consumer of major deregulatory efforts undertaken in the last 30 years have been huge. We need to get on with deregulating electric power generation, and I think the only way this Committee can contribute to it is to report a dramatic change in the one piece of the regulatory structure that comes under our jurisdiction.

I think, obviously, there's a lot of work to be done in coming up with a final vehicle to deregulate retail purchases of electricity. We have to deal with the historic sunk costs of the industry, costs that were incurred and stranded during a period in which the Federal Government regulated the process and encouraged certain types of investments.

Within those constraints of coming up with an effective vehicle to deal with stranded costs, I believe that we need to move ahead with deregulating electric power generation, allowing the consumer to make fundamental choices about buying electricity.

I know, Mr. Chairman, there have been a lot of estimates about what the savings would be with full-blown deregulation of electric power generation. Obviously, any time you're talking about the impact of dramatic change, it's hard to make estimates, but when we look at the result of deregulation on everything from telecommunications to airlines to railroads, the results have been very uniform and have basically produced tremendous benefits for the economy, improvements in the competitiveness of the economy as a whole, and benefits to the consumer.

Now, obviously, in order to support the repeal of PUHCA, you don't have to support full-blown deregulation. I happen to support it. But the point is that this is an important part of it and is the only part that we can contribute in terms of beginning this debate.

I'm ready to see the debate begin. I'm ready to move ahead. I'm working with Congressman Bliley on a bill to try to define a timetable and regimentation for full-blown deregulation, trying to come up with a methodology whereby the FERC can oversee the decisions by the States in dealing with stranded costs.

I see this, Mr. Chairman, as a major step forward and, again, I'm sure there are various Members of the Committee who would support your bill that don't support the end-point that I do, enlightenment not being equally distributed. But, in any case, I think this is a step in the right direction and I'm for it.

The CHAIRMAN. Thank you, Senator.

Senator Moseley-Braun.

OPENING STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. This debate reminds me more than most of that familiar old expression that those who forget the lessons of history are doomed to repeat them.

There is no small amount of irony in the fact that PUHCA came about because of the actions of an Illinoisan, Samuel Insole, who at the turn of the century bought up most of the utilities in the country and robbed and pillaged the consumers. Because of his actions, Congress moved in the direction of creating this—

Senator GRAMM. He went broke.

[Laughter.]

Senator MOSELEY-BRAUN. Yes, but he had stolen a lot of money.

Senator GRAMM. We passed this bill to bail him out.

Senator MOSELEY-BRAUN. He made \$60 billion first. In today's dollars, it would have been \$60 billion.

Even though Illinois, right now, does not have but one utility that's affected by PUHCA, it will become much more relevant after a merger that's pending. Presently, there are no investor-owned utilities in Illinois that are registered under this statute.

Because the history of PUHCA is so compelling, in my opinion, it seems to me that we should not rush to judgment on the repeal without knowing what the impacts are. There are still some important public policy concerns that I believe have to be considered first if we're not going to put the cart before the horse. We need to be sure before we move forward that our actions will not cause unforeseen problems for consumers. We also need to know how PUHCA repeal fits into the electric utility reform, generally.

As Senator Gramm pointed out, this is only one part of a large set of public policy issues pending before us regarding the deregulation of this industry. I think we have a lot of issues, contentious issues, that we need to address or at least to have an answer about first, including the stranded costs on existing infrastructure, should competition be immediate or phased in, will the large industries enter the market ahead of the residences? There are many questions we have to address that are within the context of electricity deregulation.

This Committee has very little energy policy before it except for this, which is one issue where we do have an impact. I believe that we do have to move in the direction of reform. In my home State right now, at the State legislative level, they are addressing electric utility reform.

At the same time, I do not believe we should undertake to make policy in this area without having a sense or a report or some handle on what the impacts will be on those who should be our first concern, the utility users, the consumers, the people who rely on our judgment in this important area.

I oppose this legislation, as I did last year. I hope, as we struggle with the whole question of restructuring this industry, that we get a better sense of what the impacts are before we move to wholesale repeal.

Thank you.

The CHAIRMAN. Thank you, Senator.
Senator Allard.

OPENING COMMENTS OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, I ask unanimous consent to put my prepared statement in the record.

I would note that I'm a cosponsor of this bill. The reason I'm cosponsoring is because I think it's one area where we can eliminate duplicative and burdensome regulations, while still protecting the rate-payer and the consumer. I think it's a common sense piece of legislation. I hope we can move it forward out of this Committee.

I know there are some side issues related to this, but my concern is that we streamline the process so that we don't have too many agencies overseeing a lot of the energy companies and, at the same time, will still be able to protect the consumer.

I think it's a good piece of legislation and I hope we can get it out of Committee, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

We will now open it up to questions of the panel.

Senator Dodd.

Senator DODD. Thank you, Mr. Chairman.

I appreciate the comments of my two colleagues on this side, Senator Bryan and Senator Carol Moseley-Braun. I misspoke earlier when I said it passed the Committee unanimously. Obviously, we had a voice vote and both Senators expressed their opposition at that time. I would just retort to both of my colleagues here.

My friend from Illinois points out history, and history is important. In 1935, when PUHCA was created, it was done so because there were abuses within these holding companies that were established and, of course, because they were abusing rate-payers. To

deal with this problem, it was decided to give regulatory authority over these issues to this new agency called the SEC. The SEC was the only agency around that could handle this because it was securities fraud matters that were basically the source of the issue.

To the SEC's credit, for over a decade, they have taken the position that now with the establishment of the FERC, among other things, it no longer makes a whole lot of sense to have the jurisdiction within the Securities and Exchange Commission as a way of dealing with the issues.

I quoted last year, Mr. Chairman, a quote from the SEC's Division of Investment Management, which very concisely summarized, I think, the importance of repealing the outdated statute.

It stated:

The regulatory system established by the Holding Company Act was not intended to reach the production and sale of gas and electricity. Congress vested the Federal Power Commission, now the Federal Energy Regulatory Commission, with jurisdiction over these operations at the Federal level, and in Section 21 of the Act preserved the right of State regulators to exercise authority over utilities. These Federal and State rate-making authorities, not the SEC, most directly protect consumer interests.

That's why we ought to change this. That's a pretty clear statement of what the point is.

My colleague from Texas has made the point on how consumers have benefited, in no small measure, as a result of some of the deregulation efforts. I pointed out before he arrived that the State of Rhode Island—Jack Reed has left—but they have seen a real reduction in rates as a result of the competition in this area. So I feel as though, as the Chairman and others know, this change is long overdue and really necessary.

I would finally quote from the 1995 SEC report. In there, it says:

As the SEC has long recognized, the current regulatory system imposes significant costs in direct administrative charges and foregone economies of scale that cannot be justified in terms of benefits to utility investors. Acting under authority in the Securities Act of 1933 and the Securities Exchange Act of 1934, the SEC has over the past six decades created a comprehensive system of investor protection that obviates the need for many of the specialized provisions of the Holding Company Act.

Again, I think that makes clear that reform is really essential, in our view, and this is the one piece we have. I'm not confident we're necessarily going to get a comprehensive piece of legislation passed on this issue. It's very, very complicated. But for us to go another year, another Congress, without moving, I think would be wrong.

I just have one question, Mr. Chairman. It has to do with the jurisdiction over affiliate transactions.

Ms. Tomasky, you will note Commissioner Hunt in his testimony repeated the SEC's recommendation that the FERC have discretion to exercise jurisdiction over these transactions, including the prior review.

Chair Elizabeth Moler wrote last year that under S. 621, the Commission has sufficient authority under the Federal Power Act to preclude public utilities and natural gas companies from charging consumers for imprudently incurred costs and for costs of goods and services that are obtained from an affiliate at an above-market

price. Accordingly, the SEC recommendation was not included in the bill.

I just wondered if Chair Moler holds the same position this year as she did the previous year.

Ms. TOMASKY. Yes, she does, Senator. The essential difference, I think, between what the SEC has suggested we could do and what we currently do really has to do with the issue of prior approval.

In our view, we treat the issue of the pass-through of costs as essentially a rate-making function. Utilities come to us. We set the rates. We figure out what they're trying to include in the rates and if we think it's improper, we say they can't charge it. We think that is a sufficient way to deal with affiliate issues, so long as we have access to the documentation necessary in order to do it.

We have never been inclined to do prior review of affiliate transactions. We have actually been asked from time to time for utilities to provide those kinds of assurances. Our tradition is really one of setting rates on the basis of actual costs. We don't think we have anything special to add in terms of the business decision pertaining to whether or not a particular transaction is appropriate, and we think the right way to deal with cost allocation and overcharge issues is through the rate-making function with adequate books and records.

Senator DODD. I see the yellow light is on, but, Mr. Hunt, what if we were to include some report language here, and perhaps in a broader sense as well? I understand the FERC is uneasy about putting explicit authority here. The implications may be that, in the absence of other provisions, having made note of it here, it might question the authority of the FERC in other areas.

I think that's a very legitimate point. I appreciate your concern and the SEC's concern, although I am satisfied that the FERC believes it has this authority. I hear no one questioning that, but maybe, Mr. Chairman, we might include some language to make clear that the Committee certainly agrees with the FERC that they have the implicit authority in this area, and that specific language in this area may not be necessary. I'll wait for the expert advice on that.

Mr. Hunt, may that be satisfactory in your view?

Mr. HUNT. I think we would defer to the FERC's expertise, Senator Dodd. We think it was appropriate to include authority for prior affiliate transaction and review on the part of the FERC. If the FERC thinks it can do its job, as it has done its job in the past, we would defer to their expertise, and including language in the report would be fine with us.

Senator DODD. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Gramm.

Senator GRAMM. Mr. Gee, I came in at the tail-end of your comments. Give me a burst transmission on what your concerns are on this issue, from the point of view of the States.

Mr. GEE. Senator Gramm, the NARUC is recommending that there be changes to the Federal Power Act and to PUHCA. In fact, much of what is contained in S. 621, we have expressed to Senator

D'Amato we favor, that in fact we believe that PUHCA does have provisions that are outdated and need to be modernized.

We do believe, however, because of the spate of utility mergers and acquisitions that have occurred since we first began discussing PUHCA repeal, which has been for over 3 years now, at least, 3 or 4 years since I've been involved in this issue, that the market structure of the utility industry has changed quite dramatically toward larger and larger companies. That could pose a real problem with respect to any individual State having the ability to monitor adequately utility affiliate transactions, operating company acquisitions, and the like.

We believe we need to modernize the Federal Power Act to make clear that it is the States that have the authority to go to customer choice to provide for full retail access, to choose from competing suppliers. That's a question which is still uncertain right now as a matter of law and quite unsettled.

The NARUC believes it is appropriate for Congress to confirm that the States can move forward and give their customers that ability to choose between competing suppliers at the retail level. Once Congress makes that confirmation, we think States will begin to move in that direction. We believe that many States already are moving in that direction.

In fact, ultimately, when you have so many States moving to provide customer choice, many of the concerns that we're talking about today with respect to maintaining customer safeguards may not be necessary, quite frankly, because once people can make a choice among competing suppliers, the concerns about diversification, the concerns about affiliate transactions simply are minimized.

We believe there is a relationship certainly between moving toward providing greater competition and minimization of regulation, deregulation, if you will, of generation, giving customers the opportunity to choose among competing suppliers in retail markets, and the maintaining of restrictions of safeguards against affiliate dealings and multi-state transactions.

We would prefer that Congress take this matter up in its totality, that they are cognizant of the concern that everything not be held up because of the inability to reach a consensus on the broader provisions which people are talking about today in terms of comprehensive reform.

The NARUC has a position which we believe represents modest but significant changes to the Federal Power Act that we believe should be considered in conjunction with PUHCA repeal or reform.

The CHAIRMAN. Senator Bryan.

Senator BRYAN. Thank you very much. Mr. Gee, I enjoyed the colloquy that you and Senator Gramm just had. I take it it's not the position of the NARUC to argue for the status quo, that that's not the ultimate from your point of view.

Mr. GEE. That's correct, Senator.

Senator BRYAN. As I understood your testimony, there is a dynamic change that's occurring in the marketplace. It's profound, something that we've never seen out there before. As a result of that, there is a great deal more action with respect to mergers and acquisitions than ever before, at least in recent history.

Would that be your experience in Texas and that of your fellow commissioners?

Mr. GEE. Yes, Senator. It's true in Texas, and in other States as well.

Senator BRYAN. So your counsel to us on behalf of the National Association is we ought not to do this as a stand-alone, isolated piece, but that it should be done as part of a comprehensive reform in which the States have the power to make sure that, in point of fact, there are no abuses.

You have gone so far as to say that you think if true competition exists, some of the restraints, regulations that currently exist with respect to diversification of affiliates, are probably unnecessary, if I understand the thrust of your testimony.

Mr. GEE. That's my personal opinion, yes, Senator.

Senator BRYAN. I take it that's the view taken by the National Association as well.

Mr. GEE. The National Association believes that the emergence of competition should be coordinated with the continuation of these oversight restraints on multi-state utility holding companies, and that there could be a need to revisit these once States have determined that their markets are competitive, sufficiently competitive so as to obviate the need for these continued restraints. Yes, sir.

Senator BRYAN. I think that's the point I'm trying to make, my difference with my colleagues. I agree that if you have a true competitive model out there where consumers do have a choice, that that's better than the current system. The question is, will you have a true competitive model? If you do not, you have the potential for abuse without the power to regulate and to prevent that.

I take it that's in essence what the National Association is saying as well.

Mr. GEE. That's our concern, yes, Senator.

Senator BRYAN. Is there any other concern with respect to any Federal pre-emption? You have made a strong argument on behalf of the ability of States to regulate. My own background is from a State perspective. I happen to share that bias.

What concerns, if any, should we focus on in terms of any potential pre-emption that this legislation could create in terms of the States to do precisely what you're suggesting ought to occur?

Mr. GEE. Thank you, Senator. In my testimony, I indicate that there is a concern about language in the bill that allows the FERC to grant exemptions to a utility from the provisions of the bill.

Our concern is that, for example, if they were to grant an exemption with respect to the books and records authority that they would otherwise assert, it might bleed into the State's ability to maintain a books and records requirement. We want to be assured that if the FERC were to grant an exemption, for example, on the books and records oversight, that it certainly not pre-empt States from requiring a books and records oversight.

The CHAIRMAN. Mr. Gee, as I recall, we have worked on this point already. If necessary, we will sit down with the Republican, Democratic, and FERC counsel this afternoon to ensure that the language is unequivocally clear that the States will not be pre-empted from their right to inspect the books and records.

Now, if we haven't yet had an agreement on the provision, that's simply because we haven't had the lawyers together in a room for 3 or 4 hours to work out definitive language.

So let's get together; if there is a question as to whether or not the language is specific enough, it should be taken care of. I am a little bit distressed to hear that at this point, after 2 years, this is still an open question because I thought that the bill guarantees the States' rights to inspection.

I remember when I was a local town official, a certain water company would charge off the costs of its operation to its other subsidiaries. It was extremely frustrating, because I couldn't get our public service commission to look at the cost charge offs in terms of cross-subsidization.

It's interesting that now the guy has become—oh, well, I won't even go into that.

[Laughter.]

It is incredible, how the rich and powerful can say one thing and do another. They even buy newspapers and say it.

The company ripped off everybody by charging all service charges to different subsidiaries and at the same time using employees, officers, and company resources to subsidize subsidiary operations. Cross-subsidization as well as unfair cost pass-throughs like these are what my colleagues are concerned about. So am I.

We will see to it that these abuses cannot happen. If you have some time, and you have some people here, when we get finished with this hearing, let's sit down and see to it that that question is addressed.

I know Senator Gramm shares that feeling, that we must ensure that the States have the authority they need. The intent of the legislation is for the States to have that authority to look at all books and records, that they not be pre-empted by the FERC. If anything, we want to make it easier for you to exercise your authority to examine books and records. At the same time, we want to ensure that the FERC has the authority they need.

If the FERC feels comfortable with the authority granted, then we can discuss in report language the affiliate transactions authority and the question of prior approval. Furthermore, we will try to clarify the provisions to ensure that they do not set a precedent against FERC authority in the future.

So I'll ask Ms. Tomasky to see how we can clarify the FERC's authority over affiliate transactions.

Ms. TOMASKY. Of course.

The CHAIRMAN. I don't see any harm in making the FERC's existing authority explicit, especially if it eases the SEC's concerns. Although Commissioner Hunt states he is willing to defer to the FERC's opinion, I don't think we want to leave that door of ambiguity open as there will definitely be problems in the future if we don't clarify now. So I think we should take care of it now.

Senator MOSELEY-BRAUN. Mr. Chairman.

The CHAIRMAN. Yes.

Senator MOSELEY-BRAUN. If I may, in his testimony, Mr. Hunt, speaking from the SEC's point of view, even refers to the continuing need to ensure the protection of consumers.

I'm going to applaud the Chairman's comments because, at a minimum, we should make certain that we don't throw the baby out with the bath water, we don't get rid of the PUHCA oversight and wind up with none to take its place.

Consumers have a lot at stake here with what can be a gap effect, in which we wind up getting rid of the protections that they enjoy at this level, but those protections end up not being replaced at another level of Government and consumers find themselves at the mercy of the monopoly power of these utilities.

I appreciate the suggestion made by the Chairman that the language be looked at to make certain that those kinds of protections are written into the law or, alternatively, are made part of the report language.

Senator BRYAN. Mr. Chairman, I think I still have a couple of minutes left in my round.

The CHAIRMAN. OK.

Senator MOSELEY-BRAUN. Sorry, Senator Bryan. I apologize.

Senator BRYAN. That's all right. I agree with you.

May I just take another minute or two?

The CHAIRMAN. Did you say you agree?

Senator BRYAN. I agree with the concerns that were expressed by the Chairman because I do think if it is not the intent to pre-empt, but rather to include language in the report, I appreciate the Chairman's willingness to sit down and look at some language that will make that possible to clearly address.

Let me just ask Ms. Tomasky: Do you see a situation in which there should be a Federal pre-emption with respect to your contemplated authority under this proposed bill?

Ms. TOMASKY. I see no reason why we would want to pre-empt the access of the States to books and records, no, sir. No circumstance at all.

Senator BRYAN. So you would agree with the observation that the Chairman made.

Ms. TOMASKY. Yes.

Senator BRYAN. Perhaps, Mr. Chairman, there is an opportunity to improve this legislation. I appreciate your willingness to do so. That may give our State regulators who are the ones out on the front line and who have the primary responsibility currently at least some comfort that, indeed, their ability to continue to regulate will be retained.

I thank the Chair. I notice that the light is beginning to show, so I will yield back my time.

The CHAIRMAN. Senator Shelby.

OPENING COMMENTS OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Mr. Chairman, I had to be at another committee hearing and I apologize for that. I have a prepared statement that I would like to have made a part of the record in its entirety, if I could. Then, I just have a couple of quick remarks.

The CHAIRMAN. So ordered. It will be entered into the record.

Senator SHELBY. Thank you, Mr. Chairman.

I think, myself, the repeal or doing away with PUHCA is long overdue. A lot of things have changed, changed drastically since PUHCA was enacted. Look at the market out there.

The Senator from Illinois has left, but she talked about the consumers. I agree. We're all consumers of utilities in this country. But I believe, and I think evidence shows, that the best protection of the consumer is competition, real competition. Not creating another bureaucracy, Mr. Chairman, to oversee this and oversee that. We've been down that road before.

I hope, Mr. Chairman, with your leadership, we will be able to do away with PUHCA. It's a dinosaur. It's something that should have been dealt with 20 years ago. I would like to commend you for your leadership.

The CHAIRMAN. Thank you, Senator.

Senator Allard.

Senator ALLARD. I have three brief questions, Mr. Chairman.

The first one is to Mr. Gee. I prefer State regulation over Federal regulation on this. In 1935, when PUHCA was enacted, I think the State regulators were generally pretty weak.

Do you think that's changed today?

Mr. GEE. I think today we have, my own personal view, quite biased, obviously, some very serious, very bright, very capable people staffing our State public utility commissions who are sensitive to the concerns of addressing full and fair competition in the electric utility market.

Senator ALLARD. So you have no doubt that the States are capable of carrying on this added responsibility?

Mr. GEE. I have no doubt that they have the ability to vigorously oversee the structural changes in the market.

My concern, however, is one of timing, as my testimony points out, the fact that our statutes need to be updated to fully reflect the changes that would be occurring if PUHCA were reformed or repealed. Another concern certainly is the additional question of resources, whether State PUC's have ample and sufficient resources to oversee the competitive concerns that would arise in a growing market.

Senator ALLARD. Ms. Tomasky, do you think that the timing is right for repeal?

Ms. TOMASKY. Sir, we think that the timing is appropriate from the perspective of rate regulators. We absolutely believe that the primary responsibility for protecting consumers is the rate regulatory agencies, both State and Federal, and that those consumer protection purposes are no longer essential.

But, fundamentally, we defer to the SEC's judgment with respect to the overall need for the Act.

Senator ALLARD. Mr. Hunt, on regulation, how are you enforcing PUHCA right now? To what extent do you, at the SEC, defer to the FERC for critical decisions under the Act?

Mr. HUNT. Sir, we have been trying to administer PUHCA in what we call an aggressive way. We have been trying to level the playing field so that the 15 holding companies under the PUHCA jurisdiction and regulation can compete in the ever-changing utility field with those exempt utility companies.

We have been trying to create a level playing field to allow them to diversify. We passed an important Rule 58 under PUHCA after the report of our staff of a couple of years ago. Under that rule, we have been trying to exempt transactions to allow the regulated

utility companies to now engage in the same kind of transactions as those exempt utility companies, such as those that are primarily intra-state companies that do not come within our purview in the PUHCA.

Senator ALLARD. So you have been deferring a lot of your decisions to the FERC.

Mr. HUNT. We have been exempting a lot of transactions and in terms of the rate-making, we always defer to the FERC.

In terms of the regulatory policies we have, we have been trying to free up the utility companies from what we think is a statute that really has outlived its usefulness from the SEC point of view. The changes in the markets, the changes in financial reporting, the continued security investor protections of the 1933 and 1934 Acts, we think provide all the consumer protection that we can provide under PUHCA.

Senator ALLARD. Thank you, Mr. Chairman. I yield back the balance of my time.

The CHAIRMAN. OK. Yes, Senator Shelby.

Senator SHELBY. Mr. Chairman, I just have a couple of questions, if I could.

Is it really necessary that State commissions have authority to audit non-utility companies?

Mr. GEE, do you want to respond?

Mr. GEE. Thank you, Senator Shelby. Yes, it is.

Senator SHELBY. Why?

Mr. GEE. Because, in many instances, we have discovered a holding company has multiple operating companies and multiple subsidiaries that are set up to provide services both for their regulated companies and nonregulated companies.

Unless the State commission has the access to the books and records of the nonregulated entity as well, it will not know whether the regulated company has been fairly allocated its share of costs because many of the costs are passed through these nonregulated entities.

Senator SHELBY. You may have gone into this already when I was not here, and I apologize if you have, but what transition period is really needed upon repeal of PUHCA, and what will occur during this period? There's always a transition.

Mr. GEE. Thank you, Senator. We favor certainly the direction that the bill takes, which is to move toward giving States a reasonable transition period.

The current bill provides for an 18-month transition. Senator, we are recommending that transition period be extended to 2 years, primarily because not all of our legislatures meet every year.

As my testimony indicates, if a State commission finds that it needs some additional authority, it may have to go back to its State legislature. But in situations such as in my own State, where our legislature will not meet again until 1999, we may be without sufficient authority in order to assert our proper jurisdiction over the activities of the regulated utility company for up to 2 years.

We're concerned that there could be an interim gap in the absence of sufficient State authority.

Senator SHELBY. OK. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Enzi.

OPENING COMMENTS OF SENATOR MICHAEL B. ENZI

Senator ENZI. Thank you very much, Mr. Chairman. I'm pleased we're holding this hearing on the Public Utilities Holding Company Act. I have been following this issue now for about 6 years.

My daughter, who is a senior in high school in Wyoming and who is out visiting me this week, had participated in a school project where they did a practice buy on some stock and then followed it for a while to see how they did.

I asked her what stock she had picked, and she told me. I asked her why she had picked that stock. She said, well, the day before, it had this huge rise. I asked, why? She said, I don't know.

We got on the computer and we looked that company up. One of the reasons that its stock had gone up is because Senator Wallop, who of course is from Wyoming, had introduced a bill on behalf of the CMS Corporation to eliminate PUHCA. We did a little more checking on the Internet and found out what PUHCA was all about and spent about an hour and a half on it.

Of course, about the time that we were finishing up, after we had spent the hour and a half, my daughter said, so why, Dad, did you look up CMS? The company I bought was CML.

[Laughter.]

Just fate, I guess. So I have had some background in the PUHCA legislation and have also been on the Energy Council, which is the Western and Southern States that produce about 90 percent of the energy for this country. They also have looked at PUHCA reform over the years.

I came by mostly to pick up the testimony. I will read all of the information that's been presented. With that, I'll yield the balance of my time.

The CHAIRMAN. Thank you. Are there any other questions that any of the Members would like to ask of the panel?

If not—

Senator BRYAN. Mr. Chairman.

The CHAIRMAN. Yes.

Senator BRYAN. It strikes me that Mr. Gee makes a very good point about the timing. The State of Texas is not alone in having a biennial legislative session. That's the experience in Nevada as well. You certainly seem to have been most responsive to the concerns about pre-emption.

Whether you agree or disagree with the legislation, whether you agree or disagree with the premise that we ought to be doing it separate as opposed to an overall comprehensive reform, I don't think anybody would intend a consequence in which something would occur and a State be unable to respond to the change in Federal law. That's a very real concern for those of us that represent States that have biennial legislative sessions which are going to adjourn before this legislation.

I do not know when in 1999 the Texas legislature meets, but in Nevada, it's the third week in January and there could be a hiatus.

I would just encourage the Chairman to consider responding to that concern. It strikes me as being very reasonable.

The CHAIRMAN. Let me say, again I think that's a very reasonable request. I've been speaking to counsel and to Senator Gramm, who expressed the same concern. I think the question is how to

best provide for the meeting of State legislatures without slowing the legislation. Obviously, it is not the intent of the Committee to take away or to limit the ability of the States to legislate in this area.

We want to ensure that the States are not pre-empted and that they have the opportunity to respond with any legislation they may deem appropriate. So I ask our counsels again to examine how best to assure that that situation is handled.

I want to say that I am very encouraged by the testimony today and I thank Mr. Gee for putting forward those concerns expressed on behalf of his colleagues throughout the Nation, the State regulators. Indeed, I think in at least the two areas we have discussed, we can clarify and make certain that those concerns are addressed. I would not support this legislation unless those concerns were adequately addressed.

I would ask that we stay right on this. Time has a way of slipping and if we put it aside, then we won't address these issues for another month. I would like to work on that now so that when we bring this to markup, those concerns will have been dealt with.

Mr. GEE. We very much appreciate the opportunity to work with you, Senator. Thank you.

The CHAIRMAN. I want to thank all of the witnesses for their testimony and also for their help and cooperation in bringing us to this point.

Mr. GEE. Thank you, Senator.

Mr. HUNT. Thank you.

Ms. TOMASKY. Thank you.

The CHAIRMAN. We will now call our third panel. I would ask our panelists to adhere to the time limitation. We will be able to take all of your testimony as if read in its entirety.

We'll start with Mr. Tanski, the Vice President and Controller of National Fuel Gas Distribution Corporation in Buffalo, New York.

Mr. Tanski.

**OPENING STATEMENT OF RONALD J. TANSKI
VICE PRESIDENT AND CONTROLLER
NATIONAL FUEL GAS DISTRIBUTION CORPORATION
BUFFALO, NEW YORK**

Mr. TANSKI. Good morning, Mr. Chairman and Members of the Committee. My name is Ronald Tanski and I'm Vice President and Controller of National Fuel Gas Distribution Corporation, the public utility subsidiary of National Fuel Gas Company. National Fuel is one of only three registered natural gas holding companies and the only registered company in New York State. I am here to emphasize our continuing support for reform of the Holding Company Act, subject to the need for uniform inter-state treatment of holding company systems.

At the hearing before this Committee last June on the predecessor to S. 621, we all debated our views on the issue of PUHCA reform. Having heard the testimony from other parties, it is clear that National Fuel's initial perspective, that simple PUHCA repeal would minimize our regulatory burdens, was itself overly simple. I say this now because PUHCA repeal alone is clearly unacceptable to many other interested parties, especially consumer groups.

Consumer groups, among others, believe in the event of outright PUHCA repeal, market power issues will require additional FERC and State review authority over holding company financial transactions and investments. With due regard to those concerns, National Fuel, which has businesses regulated by the FERC and two State utility commissions, has its own concerns about additional regulatory burdens on three fronts. In particular, we strongly believe that granting powers of review over holding company activities to 50 State agencies and the FERC will, without doubt, result in increased and uncoordinated burdens on all companies in our holding company system. With repeal of the Act and the proposed extension of authority to 51 agencies, no one entity will be charged with the duty of adopting a balanced approach that gives weight to all interests and implements appropriate protections.

For these reasons, while still actively supporting reform in the public utility holding company arena, National Fuel believes that PUHCA reform must also include some narrow retention of SEC authority over financial matters and a continued SEC role in the auditing of such matters.

I want to emphasize my company's continued position that repeal of the restrictions on investment in our now almost completely deregulated gas industry should happen immediately. National Fuel is part of an industry which has been through a difficult, wrenching restructuring and is now operating in a robustly competitive environment. The 1935 Act imposes burdensome regulation which hinders that competition.

Those who advocate waiting for electric industry restructuring ignore the fact that the natural gas industry has already restructured, yet it remains subject to requirements that limit its flexibility to respond to constantly changing market conditions.

When PUHCA was first enacted 62 years ago, our industry was a vertically integrated utility system which would produce natural gas, transport that gas by pipeline, and distribute it to all retail customers in a geographically restricted service territory.

Today's natural gas industry no longer bears any significant relationship to the natural gas industry of 1935. Wellhead prices have been decontrolled and prices are set by the market.

Pipeline rates remain regulated by the FERC, but the rates and services have been unbundled. Customers can purchase transportation, storage, and other services separately and the pipeline no longer bundles the services for a single inclusive rate.

Brokers, hub operators, as well as the marketers compete for our customers in providing mixes of services. These nonregulated companies provide at market prices the bundling that regulated pipelines once performed.

Local distribution to retail customers remains subject to State commission requirements, but in many States these very same customers have the opportunity to purchase gas at the wellhead and arrange their own transportation of that gas.

Last year, the major utilities in New York filed new tariffs designed to unbundle their retail services. Our New York residential customers are now able to choose their natural gas supplier. Residential customer choice will soon be available in our Pennsylvania utility operation through our recently filed "Energy Select" pilot

program. Most of the suppliers competing, or soon to be competing, with us are completely unregulated. As I'm driving to work in the morning, I can hear advertising on my car radio urging listeners to buy their energy from an unregulated company headquartered over 1,400 miles away. In the meantime, National Fuel must deal with significant regulations at both the State and Federal levels.

We're committed to allowing our customers a choice of suppliers and we will provide the transportation of those volumes. But in order to be able to compete against unregulated marketers who can change their prices and services offerings on a moment's notice, we must reduce the burden of regulation.

We must be careful, however, not to replace the 1935 Act with more burdensome and extensive regulation. As currently drafted, S. 621 grants oversight authority to at least 51 different agencies. Given that State agencies, in particular, have a narrowly defined geographic interest, they just cannot be considered the best entities to oversee the implementation of a consistent inter-state consumer and investor protection policy. Hence, to the extent that regulatory oversight of the financial transactions of holding company systems should continue, it should rest with the SEC, a well-respected body with significant expertise and continued experience in the area.

Thank you, Mr. Chairman, for the opportunity to testify before the Committee and I would be pleased to answer any questions.

The CHAIRMAN. Well, you'll get no reform at that rate. I have to tell you, you cannot simply say you want to repeal PUHCA and not permit the State PUC's to have access to the books and records as it relates to rates. It's unreasonable.

Mr. TANSKI. Mr. Chairman—

The CHAIRMAN. You're in a Catch-22 now. You say you want the relief, but you don't want the States to have the ability to regulate?

I don't see an increased regulatory burden being placed on you. I see you getting out of a situation where you have at least three regulators to go to—you need the pre-approval of the SEC, then the FERC, and then the State regulators.

Now, the one thing that we are saying, quite clearly, is that the States will have access to all books and records to prevent cross-subsidization and unfair rate increases. I believe that the States exercise their existing authority in this area already. You can take them to court to try to test the authority, but that will give you more trouble. You know that. If you start fighting with the State utility commissioners, your regulators, they'll just give you a heck of a hard time.

If you have some questions about what the legislation is intended to achieve, we better sit down with the staff and go over this very carefully.

I do not think your testimony suggests the proper way in which to proceed—we will not just repeal PUHCA and let you do anything. You're going to say, just revoke and let us do whatever we want, but also keep the SEC involved because now you want their regulation?

That would be the status quo.

Mr. TANSKI. Mr. Chairman, that was not meant to be the intent of the testimony.

Our point is—

The CHAIRMAN. Well, if it wasn't the intent, you better look at the testimony again. Let's go through the other witnesses, all right, while you sort out what your testimony was intended to mean.

Mr. Meyer.

**OPENING STATEMENT OF FERD C. (BUZZY) MEYER, JR.
SENIOR VICE PRESIDENT AND GENERAL COUNSEL
CENTRAL AND SOUTH WEST CORPORATION, DALLAS, TEXAS**

Mr. MEYER. Mr. Chairman, my name is Ferd Meyer and I'm Senior Vice President and General Counsel of Central and South West Corporation. We are one of the registered holding companies with electric utility properties operating in four States, Texas, Louisiana, Arkansas, and Oklahoma.

We have been in favor of repeal of the Holding Company Act for many years. I believe we started in 1982, if not before then, at a time when repeal first had some life, but later died. We also took a leading role in the 1994 SEC conferences.

I don't know that I want to take your time this morning talking about all the vices of the Act. I think they've been covered by other speakers.

We do not have a problem with the protection the Committee would like to put into the Act. I would only say that my view now is that the States do have that protection. But if it needs to be in there more specifically, fine.

We're talking about an Act that does not have anything really to do with rate-making. The rate-making function is vested in the FERC and the State commissions. If you do apply for rates, as the General Counsel of the FERC testified, and you wish to put into those rates the subsidiary conduct, then, of course, you have to disclose those books and records to the States to support that inclusion. In fact, we recently went through a rate case in Texas where a large part of the costs of our service company were disallowed by the Texas commission because they didn't believe they were sufficiently specific to be allowed in rates.

The other point that I would like to make to the Committee, and I regret that some of your constituents are not here at the moment, this Act wasn't merely passed for the protection of consumers. This Act had, as one of its main purposes, the protection of investors. Remember the failure of the Insole empire, the real hurt in the country was that millions and millions of investors who were sold stocks and bonds door to door found their paper to be worthless.

What has happened and what I think makes this Act most unnecessary today is the effect of the 1933 and 1934 Acts within the jurisdiction of the Banking Committee. With the old saying that sunlight is the best disinfectant, all of our books, records, and security reporting under those Acts have been made fully available to the public investor.

I am also very, very concerned, and I may be leaving the subject slightly, that in this debate about consumer protection, we forget about the investor who has invested literally billions of dollars in utility assets when suddenly people say, well, that's just too bad. We'll just move on to competition and it's just too bad you invested.

That's a violation, in my view, of the clearly articulated rules of the States. Further, it's my position that it's a violation of the Fifth

Amendment of the Constitution in that it involves a taking of those person's property. But that's another argument.

I agree with the Senator that this Act should go through clean, that it is pro-consumer. I think it's also pro-investor. I don't see anything that would hurt the investor that's not already protected in the 1933 and 1934 Acts. In addition, I don't see anything that does not presently protect the consumer that's not already included in these Acts.

If there's anything further that the NARUC feels that it needs, of course, we are more than willing to cooperate in the drafting of such language, although I think the protection is presently there.

Thank you, Senator.

The CHAIRMAN. Thank you, Mr. Meyer.

Mr. LoBaugh.

**OPENING STATEMENT OF LES E. LOBAUGH, JR.
VICE PRESIDENT, GENERAL COUNSEL
AND CHIEF ENVIRONMENTAL OFFICER
PACIFIC ENTERPRISES, LOS ANGELES, CALIFORNIA**

Mr. LOBAUGH. Thank you, Mr. Chairman. I'm here today to discuss the conditional repeal of the Public Utility Holding Company Act from the perspective of an exempt holding company, which is Pacific Enterprises circumstances. I'm the Vice President, General Counsel, and Chief Environmental Officer of that corporation, and it's the parent company of SoCalGas, the largest gas utility in the United States.

Pacific Enterprises is currently engaged in a process of obtaining approvals for a planned merger with the Enova Corp., which is the parent company of San Diego Gas & Electric Company, a combined utility. That combined utility will be structured as a holding company and will likewise be exempt from PUHCA.

From the PE current perspective, we look upon PUHCA not relating to the merger itself, but as an incident that affects and relates to our past history and the future of the industry. PUHCA blocks efficiencies, in our opinion, and productivity gains in our Nation's gas and electric utilities. Conditional repeal of PUHCA would enable utility investors, in our opinion, and customers to reap the benefits of these efficiency and productivity gains.

SoCalGas has been a top performer in the gas industry for a long time and it has developed that core competency in gas distribution over more than 100 years. A logical path for the development of that company or for the growth in financial health for PE, its shareholders, and the consumers it serves would be through the acquisition of gas distribution systems outside of the State of California, and for that combined company, the Enova PE Company, to do likewise and provide related utility services.

However, under PUHCA, PE could not acquire a gas distribution company in most States in the United States. In fact, one of the ironic things about PUHCA is that PE can acquire gas distribution companies in other countries such as in Argentina and in Mexico, which it has done, but could not do so in Arkansas. This is not a good circumstance for U.S. consumers. This is an unfortunate consequence of an Act that is long outdated and overly restrictive in its nature.

There are three issues I understand the staff has raised that I would like to comment upon. One, what market power issues are raised by conditional repeal of PUHCA? Two, what consumer protection questions are raised by conditional repeal? Finally, should the conditional repeal be treated on a stand-alone basis or only in conjunction with electric restructuring?

First, in reference to the market power issue, I think I can speak to that because we've had a great deal of experience dealing with the regulators on both the Federal and State issue in light of the proposed merger with Enova.

Market power issues are heavily regulated by the FERC, the Department of Justice, as well as various State regulatory agencies. The conditional repeal of PUHCA does not in any way diminish the authority and scope of responsibility of any of those agencies to deal with those issues as they relate to merger, acquisition, or any other activity. In fact, our experience with the merger has clearly demonstrated that the regulators look very closely at the market power issues. We've met with the DOJ on numerous occasions. We have biweekly telephone conferences with the State Attorney General's office. We've dealt with the PUC staff and other intervenors on that. We've also dealt with the FERC and the ongoing procedures on market power as well.

There is a great facility for intervenors, regulatory people, and other competitors or potential competitors to raise those issues and make sure that they are exhaustively reviewed under current regulation, and none of that has anything to do with PUHCA.

Second, in reference to consumer protection, the opponents of the conditional repeal argue that PUHCA protects consumers from the risk of diversification.

That is simply not true. Not only has the SEC determined that no consumer protection questions are raised by the conditional repeal of PUHCA, as I understand their position, our experience in failed non-utility diversification programs has proved, in my opinion, that the State regulatory authority is sufficient to insulate the utility and its customers from the risk of diversification.

Now, let me explain just what I mean by that. In our company's history, partly because of the existence of PUHCA, we engaged in a very broad-based and in-depth, non-utility-related diversification for the company.

Utility customers were protected through this non-utility diversification because of the existence of our holding company structure and by the fact that non-utility companies were placed as separate subsidiaries under the holding company, not under the utility and not merged into the utility.

We lost in excess of \$1 billion because of that diversification procedure in non-utility-related areas. In fact, those losses in 1 year exceeded the utility's entire earnings. We had to suspend the dividend and restructure the company radically. We have, since then, reinstated the dividend and have paid down the debt. Yet, in spite of this tremendous loss in the non-utility diversification activities, the cost of utility service for our gas company in California never rose one single cent, the quality of utility service was never diminished, and the ability of the utility to finance all of its capital projects was never threatened.

This is, of course, due to those benefits which are offered by a holding company structure, as well as to the scope and breadth of State regulatory authority over the utility rate-making under activities. The PUHCA did not protect the utility customers in any way whatsoever. If anything, it may have been a factor that led us to decisions to broaden the company's investments outside of the core business which we knew best.

We urge this Committee to move quickly to vote out, and hopefully for the Senate to approve, Senate Bill 621. We believe that's in the best interest of consumers and we believe it's in the best interest of the industry and of utility customers as well. In terms of holding it up for electric restructuring in general, we think that's unnecessary and inappropriate. The gas industry is largely deregulated. At some point soon, the electric industry will be as well.

The arguments I've heard today on that remind me of a discussion I had with my son. I took my young son during spring break to Egypt. While looking at the pyramids, we started discussing how the pyramid was built. He was amazed at the fact that these huge blocks, these huge stones, were placed one stone at a time to build the pyramid.

I joked with him and suggested, think how much more difficult it would have been if they had built the pyramid in one piece and tried to move it on a plane.

Some of the people who are suggesting that PUHCA be held up until all the electric restructuring, remind me of that architectural approach to doing things.

I would be happy to answer any questions.

The CHAIRMAN. Thank you.

Dr. Cooper.

**OPENING STATEMENT OF DR. MARK N. COOPER
DIRECTOR OF RESEARCH
CONSUMER FEDERATION OF AMERICA**

Dr. COOPER. Thank you very much, Mr. Chairman. Composed of over 240 State and local groups, CFA has an ongoing and active interest in electricity reform.

As Director of Research for CFA, I have testified before Congress and Federal agencies about utility reform approximately 50 times. As an expert witness representing consumer groups, low-income groups, Attorneys General, and people's counsels, I've testified over 100 times before three dozen State utility commissions. Based on that experience, we offer the following observations on the repeal of PUHCA.

PUHCA provides essential consumer protections. Premature repeal would expose consumers to abusive transactions, would make the regulation of abusive corporate transactions and risky financial dealings more difficult, and would make the introduction of competition more difficult. The alleged inefficiencies created by PUHCA regulation are vastly overstated. The introduction of effective competition into the industry should come before repeal of PUHCA.

The regulation of transactions under PUHCA is sufficiently rigorous to dissuade most utilities from engaging in multi-state, non-contiguous, and diversified activities. As a result, PUHCA prevents the development of complex corporate holding companies that span

across many State and international borders and evade regulation. By imposing rigorous regulation, PUHCA effects a structural solution. Companies just don't do certain things so they can avoid being regulated by PUHCA.

If PUHCA is repealed, this consumer protection would be lost. A vast array of abusive transactions, presently eliminated from the marketplace, would rapidly grow. Attention and resources would be devoted to the acquisition of assets that would build market power. Cash would be diverted from the utility operations of multi-state holding companies to the diversification of activities into unrelated and speculative undertakings.

That is the lesson we have learned from the activities of multi-state holding companies which are not subject to the Public Utility Holding Company Act. That is the lesson that we've learned from other industries.

Regulation cannot replace PUHCA's structural protections simply because there is not a comprehensive scheme of Federal and State regulation in place in this country. What we have is a hodgepodge of conflicting and partial authorities. We have agencies with inadequate powers, agencies with inadequate resources and authorities.

Repeal of PUHCA would confront these regulators with vast empires of interconnected companies, hundreds and hundreds of companies that they would have a great deal of difficulty overseeing.

We do not believe the FERC can or will provide the same level of protection as PUHCA does. It has simply not shown the inclination to do so and we doubt that Congress would ever provide it the resources.

The fact that the SEC has been lax in its PUHCA implementation in recent years is no reason to repeal the Act. Rather, we think we should appoint commissioners who fully understand the consumer protections of the Act and get Congress to exercise oversight so they exercise their authority.

Now, just as regulation cannot protect consumers, we don't think competition is adequate to do so. Nor is it likely to be out there sufficiently in the near-term, or even the mid-term, to provide those protections.

In the electric utility industry, we still have monopolies in local distribution and transmission. Local generation is not vigorously competitive. Furthermore, in no case has any State legislation required the complete divestiture of generation assets or precluded the reintegration of generation with other utility functions as part of a restructuring.

Premature repeal of PUHCA would actually make it more difficult to introduce competition. It would allow for a small number of enormous, multi-state entities to acquire additional utilities. They would easily amass market power in regional generation markets. Exempt holding companies could expand to gobble up their neighbors, again, creating regional monopolies for highly concentrated markets.

The Consumer Federation of America firmly believes that competition is good for consumers and we have done so for decades. However, we have learned over the years that the rhetoric of competition frequently far outstrips the reality.

Nothing we have seen in the Federal legislation or State-driven restructuring of the electric utility industry gives us the confidence to believe that in the near-term, competition will protect the residential rate-payer.

Under these circumstances, we believe the repeal of PUHCA is premature. There is no reason to unleash these massive companies to make matters worse and then hope that Congress addresses the problem later. Repeal of PUHCA should be the last step on the road to competition, not the first. In order to prevent the structural abuses that PUHCA currently prohibits, we would suggest at least two critical factors be considered when the time for PUHCA repeal becomes appropriate.

First, the only way to prevent abuse of affiliate transactions is to require divestiture of potentially competitive market segments from remaining market monopoly segments.

Second, the only way to prevent the abuse of market power in any industry segment is to impose a specific competitiveness standard before companies are exempted from PUHCA.

The public deserves no less than full regulatory oversight until effective competition is demonstrated to exist so that market forces can effectively take the place of regulation.

Repeal of PUHCA clearly puts the cart before the horse.

Thank you.

The CHAIRMAN. Thank you.

Mr. Frimerman.

**OPENING STATEMENT OF LARRY A. FRIMERMAN
FEDERAL LIAISON, OHIO CONSUMERS' COUNSEL
COLUMBUS, OHIO
ON BEHALF OF THE NATIONAL ASSOCIATION OF
STATE UTILITY CONSUMER ADVOCATES**

Mr. FRIMERMAN. Thank you very much, Mr. Chairman, Members of the Committee. I'm Larry Frimerman, Federal Liaison with the Ohio Consumers' Counsel and Chairman of the National Association of State Utility Consumer Advocates Electricity Committee. I am representing both OCC and the NASUCA today. The NASUCA is comprised of 41 consumer advocate offices designated by State law to represent utility consumers. Thank you for this opportunity to testify today.

PUHCA must be considered in the context of creating an industry structure which limits market power for electricity buyers and sellers and uses a combination of effective regulation and effective competition to protect consumers. Such a market does not currently exist today.

Public utility holding companies and their subsidiaries have activities which extend over many States and are not susceptible to effective control by any individual State. If PUHCA were repealed today in the manner proposed in S. 621, neither the remaining regulatory framework nor the current state of competition would be sufficient to protect consumers. Until utility market power is eliminated, consumers must be protected by effective regulation which, in the case of multi-state holding companies, includes PUHCA.

Effective regulation of multi-state companies requires both rate reviews and structural restrictions.

S. 621 does not just concern the registered holding companies. If PUHCA is repealed, we will see rampant consolidations and the increased pace of mergers toward multi-state structures in order to evade State regulation.

Competition might benefit consumers through reduced costs, but deregulation under conditions of unfettered market power harms consumers.

Utilities retain substantial market power in the distribution and transmission functions as well as, to a certain extent, the generation function. Yet, S. 621 could worsen problems associated with monopoly power.

For example, repeal of PUHCA's integration requirement would weaken the ability of State regulators to protect rate-payers from monopoly abuse. It would open the door to expanded opportunities for forum shopping and Federal pre-emption of State commissions in the assignment of generation costs as a result of the *Mississippi Power & Light* decision. It could also increase the potential for nationwide market concentration through unrestricted acquisitions of noncontiguous utilities by companies retaining market power without competition in their own service territories.

This doesn't level the playing field. On the contrary, it's like forcing the Banking Committee to play against the Chicago Bulls.

There are other problems.

[Laughter.]

It expands utility diversification, which increases the complexity of tracking and allocating costs and preventing cross-subsidization. This increasing of the complex company structures would make it more difficult to detect and deflect inappropriate affiliate transactions between competitive and monopoly business components or to prevent anti-competitive behavior or market power abuses.

As a result of their retail franchises and access to customers and information, electric utility holding companies retain a large market advantage in many non-utility markets. Without addressing this market power problem, utilities could trample competition in both utility and non-utility businesses.

Many State regulators lack adequate authority and resources to fill regulatory gaps left by PUHCA repeal, particularly as holding companies become highly diversified and geographically distant, as S. 621 would permit.

Incidentally, it looks as if it would be very difficult to imagine that all 50 States would have success in passing statutes which would take the place of various provisions of PUHCA in any kind of timely fashion.

It's PUHCA's structural protections and outright bans of certain actions and behaviors that can't be replaced or matched by S. 621 or other measures.

The Committee should take a close look at who is for and who is against stand-alone PUHCA repeal. The primary proponents of repeal are most of the registered holding companies and the SEC and, to a certain extent, apparently, the FERC. Opponents include all major consumer groups representing residential, commercial, and industrial customers, heating and air conditioning contractors, environmental groups, State utility commissions, and other organi-

zations, even a registered gas holding company. There is no consensus for repeal because the bill will harm consumers.

S. 621 does contain a continued Federal role in policing the inter-affiliate transactions in audits of books and records. But this language is insufficient to protect the rate-payers in competition from abuse.

In fact, the bill provides little to supplant the loss of authority over the integration requirement, the diversification oversight and prohibition, and structural protections and firewalls.

The registered holding companies want out of PUHCA because they want to get a leg up on competition to expand their customer base and broaden their market power prior to facing competition themselves. This greatly increases the likelihood that they and nobody else will be the dominant market players in a future market. This will smother competition in its infancy and will prove costly to consumers.

In conclusion, premature repeal or substantial reform of PUHCA, as contemplated in S. 621, outside of the context of a broader restructuring of the industry is totally inappropriate given the current flaws in the structure of the electricity markets and natural gas markets.

To repeal this anti-empire-building statute at such a time when structural abuses could still become the order of the day would be dangerous.

Thank you very much for the opportunity to testify.

The CHAIRMAN. I think we have an interesting diversity of testimony. I decline the offer to take on Michael Jordan and the Bulls. [Laughter.]

Let me ask Mr. Meyer and Mr. LoBaugh if they would care to respond to whether or not consumers would be in greater danger from a revival of abusive practices such as overloading operating companies with debt and building excessive charges if S. 621 were to pass?

Mr. MEYER. Mr. Chairman, I think, first, you would have both the FERC and the State commissions. You would be unable to do those things.

In the second place, I don't think the marketplace would allow it, the abuses of the past. I don't think you could sell securities or raise money in the marketplace with any of those abuses.

You have to remember, those abuses were pretty severe. Double-leveraging, for example, leverage debt at one level and then leverage again at the next level, leverage again at the level after that. Another example is the exorbitant charges that were charged to the operating companies. That was the abuse that hurt consumers. The other, the leveraging abuse, was the one that hurt investors.

I don't think the SEC, in its ability to control the issuance of securities, is going to allow that now that we have—

The CHAIRMAN. Does S. 621 in any way whatsoever diminish the SEC's authority over the issuance of securities and debt, and the proper structure of offerings?

Mr. MEYER. No, sir.

The CHAIRMAN. Mr. LoBaugh, would you care to respond?

Mr. LOBAUGH. Concerning the issues of rates for the utilities, whether it's utilities under the Federal Power Act or Natural Gas

Act, the pipeline, which I heard someone make mention of earlier, which I don't think is relevant here, or State utilities, under the State utility commissions, it is the FERC and it is the PUC's that are going to establish those rates and determine whether or not costs that may be charged or not charged by an affiliate or holding company to a utility are going to be allowed.

Those things are hotly contested. Staffs audit books and records. People in the utility companies have to put on their evidentiary showing to allow those costs to be collected and rates that are not proven to be justified are disallowed, either at the FERC or at the PUC level.

None of that has anything to do with PUHCA. I don't really see any relationship between the issue that's raised here and PUHCA itself.

There is an irony here in PUHCA, however, that, under the current PUHCA structure, utilities such as ourselves, because we have raised the utility up in the parent company and have become an operating utility, could then go out and acquire other utilities in adjacent States. For instance, we could acquire these other utilities by merging them in as divisions or aspects of the then-existing utility. I suspect that would be more difficult for our State regulatory bodies to deal with in terms of allocation of costs and oversight, but would be consistent, nevertheless, with PUHCA.

But it would be more difficult in the current situation. Also, if we were to acquire a utility outside the State, I think the States would find it easier to deal with this in a holding company structure than in a multi-state utility structure in terms of tracking the allocation of cost.

My experience has been that all the States, certainly California and the ones I'm familiar with outside of California, have been very vigorous and very effective in terms of pursuing those issues and are highly qualified to review those and do a great job.

Mr. MEYER. Mr. Chairman, much of what you have heard about the competitive marketplace again is Senator Murkowski and the Energy Committee's jurisdiction.

The CHAIRMAN. Yes.

Mr. MEYER. It really doesn't belong as a part of this because there is ample protection. Wherever we are going to go, whether there's going to be a State-by-State experiment with competition or Congress is going to act on it, I think there's going to be a great national debate.

But that is a different debate than what we're having here this morning. We have a piece of antiquated legislation here that serves no purpose.

The CHAIRMAN. Dr. Cooper, I see you want to respond and I want to give you the opportunity to respond. I read the Consumer Federation of America's statement on this bill, and although we've worked together on a number of occasions and I hope we will continue to work together, I think on this issue we have a difference of opinion.

I don't understand, and you might explain to me, without just saying you want to wait for a comprehensive bill and competition. Now, what protection do the consumers get now under the existing law that they would not receive after the enactment of S. 621?

What existing consumer protection would be lost if we enhance the ability of the State regulators and if the FERC is now actually doing the work, as a practical matter?

The SEC is not engaged in this pre-approval process. It is the FERC that is doing the substantive work. So explain what consumer protections are actually going to be stripped away.

Dr. COOPER. The interesting thing is to call it an antiquated piece of legislation that does nothing, and then hear the companies scream and shout about what it prevents them from doing.

In point of fact, it effectuates a structural solution. It convinces the vast majority of companies that they do not want to engage in the kinds of transactions that would cause them to be regulated and pass the fundamental tests of PUHCA.

PUHCA will allow you to acquire a neighboring utility if you can prove an integration benefit. PUHCA will allow you to engage in transactions if you price them at cost. If a utility wants to become a multi-state entity and go there, it has to meet these tests.

Most utilities have decided they do not want to engage in those activities. We believe those activities are inherently prone to abuse.

I have personally gained this experience from having spent the last 10 or 12 years involved with telephone utility holding companies which were not subject to PUHCA.

I frequently stated in public and in private that I wish we had a TUHCA—a telephone utility holding company act—because I've been in cases where the State PUC in Virginia says, how do you develop a service? The answer from Bell Atlantic is we do that in Philadelphia. You never do quite get an answer.

Now if a commission is dedicated and spends all of its resources, it can try to wrestle a holding company to earth. But, in point of fact, few commissions have the resources and authority to do so.

Our answer is simple. There's a whole range of transactions that simply do not take place today because of PUHCA, because the companies out there don't want to be regulated subject to PUHCA. Your bill would say, let those transactions take place and then we'll see if the regulators can keep up with them. Our answer is that the regulators will not be able to keep up with them. The only thing that could actually discipline those transactions would be an effectively competitive marketplace because you couldn't shift your costs over here. There would be a competitor there to slap your hands. So we want that competitive marketplace there first as part of that process.

I have suggested at least a couple of things you could say in a PUHCA repeal bill, as part of the whole vehicle, which would give us better assurances. That is, we think divestiture is the way to go. That is, to separate out the competitive assets from the monopoly assets. That's where we see the protections.

These transactions don't take place and you say, well, let them do the deals and we'll see if the regulators can keep up. Our answer is we don't think the regulators will be able to. Only competition will be. That's why we want to work on competition first.

The CHAIRMAN. OK. I'm going to turn to Senator Faircloth and then ask Mr. Meyer, Mr. LoBaugh, and Mr. Tanski if they would care to respond.

Senator Faircloth.

OPENING STATEMENT OF SENATOR LAUCH FAIRCLOTH

Senator FAIRCLOTH. Thank you, Mr. Chairman. I'm well aware that all this has been said, but I haven't said it. So—

[Laughter.]

I was an original cosponsor of this bill last year. What I believe the issue to be, very simply, is do we need the SEC regulating utility holding companies? The answer is clearly, we do not.

PUHCA requires the regulation of only 15 companies. Yet, there are hundreds of other utility companies subject to the Act.

I think the Federal Energy Regulatory Commission and the State supervisors are more than adequate to meet the challenges of regulating the holding companies today. The utilities commission in North Carolina came under my purview as Secretary of Commerce for 7 years. We certainly experienced no problems.

Mr. Chairman, let me say that I'm sensitive to the concerns of many businesses that believe they will be captive customers to the deregulated power companies.

But the real answer to lowering energy cost is allowing utility companies to diversify their activities. The utility companies have a great opportunity to expand and vast technology for change, and I think we should let them do it.

Do you want to go ahead with a question or do you want me to?

The CHAIRMAN. If you have a question, Senator, why don't you pose the question.

Senator FAIRCLOTH. Mr. Meyer.

Mr. MEYER. Yes, sir.

Senator FAIRCLOTH. In the long run, is your company going to be better off by being able to diversify the operation?

Mr. MEYER. We believe that we will, if we stay with our netting, which we intend to do.

Senator FAIRCLOTH. Do you intend to diversify?

Mr. MEYER. Yes, we do, in services that are related to the basic electric service.

Senator FAIRCLOTH. Such as?

Mr. MEYER. Telephone, cable, what we call demand-side management. That is, putting the smart box in the home. You can hook it to the home computer or we could offer time-of-day rates to the customer. We could offer very, very low rates at night, higher rates in the afternoon. We already have an experiment of that kind going on in Laredo.

Once you connect to the customer with that broad band fiber-optic ability, you can carry all sorts of other things to the home.

Senator FAIRCLOTH. Are you looking at any gas companies, pipelines, things of that nature?

Mr. MEYER. We have in the past. We're not presently.

Senator FAIRCLOTH. You don't have any now?

Mr. MEYER. No, sir. But we think that there would be a great deal of savings for us to own local distribution companies in areas where we also have electric service. Some companies are doing that at this moment. Texas Utilities has a merger underway.

Senator FAIRCLOTH. Where would the savings come from?

Mr. MEYER. Texas.

[Laughter.]

Senator FAIRCLOTH. You say there would be a great deal of savings concerning the gas. Where would the savings—

Mr. MEYER. Common meter reading, common servicing, common consumer services.

Senator FAIRCLOTH. Now I'm having a little trouble. How does a gas service relate to electric service?

Mr. MEYER. Both services have meters which have to be read. Both have to have a certain amount of service, depending on line breakage, so forth. You could cross-train. You could certainly have common meter readers. You could also cross-train your employees for service matters.

We have companies that are gas and electric companies presently in existence that are exempt companies. We have mergers that are going on presently between the local distribution companies and electric companies.

Senator FAIRCLOTH. Mr. LoBaugh, would you tell me the experiences with diversification that your companies have had and what the effect has been?

Mr. LOBAUGH. As I commented earlier, we diversified into non-utility activities starting around 1970 or so into—

Senator FAIRCLOTH. What non-utility?

Mr. LOBAUGH. Agricultural, real estate, drug stores and sporting goods stores, and oil E&P operations.

Senator FAIRCLOTH. What phase of agriculture?

Mr. LOBAUGH. The citrus packing as well as pistachio nuts and things of that nature. We sold off the agricultural, redeployed that capital, and went into the retail business, drug stores and sporting goods stores, as well as the E&P area.

We have sold off, as I indicated earlier, all of those activities and concluded that we shall stick to the core business, utility related activities and the utility itself.

In response to the question you gave Mr. Meyer, on one of the comments from Dr. Cooper, let me talk just briefly about one of our current experiences in utility-related activities and merger, and that is the one with Enova.

We are proposing that when the merger is completed, the two holding companies will be subholding companies of a new holding company, that the utilities, in essence, remain separate operating corporate entities, both regulated by the California Public Utility Commission.

If the State of California, for instance, was divided into two separate States so that San Diego and Enova were each in a different State, that merger would not be permissible under PUHCA.

The benefits that we have projected and agreed to create as a result of that synergy is \$1.2 billion after the cost of implementation over 10 years. Under State regulatory law, at least 50 percent of that must be reflected in terms of reduction of rates to the utility customers served by SoCalGas and by Enova. That kind of benefit and savings to consumers simply would not have been possible had PUHCA been a prohibition to that kind of merger.

Savings are going to come in terms of the general corporate overhead, things such as reducing the number of officers in the officer executive group of the two holding companies by 14, which is my estimate. We will have a common law department, common public

affairs, shareholder relations. Perhaps common billing is possible. You mentioned common meter reading.

Our two service territories do not significantly overlap. There's only 70,000 customers where there's an overlapping territory out of—we have 4.7 million meters and Enova has, with its utility, over 1 million. That's really a relatively small portion.

On the other hand, if the service territories overlapped, you can well imagine the savings to the consumers would be dramatically greater.

Senator FAIRCLOTH. How were your customers' rates affected by your diversification?

Mr. LOBAUGH. The utility rates were never affected whatsoever. The shareholder's value was diminished by in excess of \$1 billion, but the utility rates were not affected one penny.

The CHAIRMAN. Mr. Frimerman, I could see you hopping up and down. Go ahead. Dr. Cooper is writing his response furiously.

[Laughter.]

Dr. Cooper, I don't know if we have enough time for you to translate all those notes into a speech.

[Laughter.]

Dr. COOPER. Give me a chance.

The CHAIRMAN. I know you will try.

[Laughter.]

Mr. Frimerman.

Mr. FRIMERMAN. I wanted to at least say a couple of things that related to what's been said about placing consumers at risk.

For one, if you look at the repeal of the Holding Company Act without addressing some of the Federal Power Act issues such as reversing the *Mississippi Power & Light* decision, which pre-empts the State utility regulators from effectively being able to control the pass-through of imprudent costs on to rate-payers for multi-state utility holding companies, then you are not really addressing the problem. You're creating a significant regulatory gap.

So what could happen, ostensibly, is that consumers could end up paying for an expanded list of abuses and of overcharges simply because you have situations where geographically distant utilities would be able to sell under the FERC jurisdiction perhaps and not be subject to effective State regulation. That is a problem.

Another problem is that by permitting additional investments, significant, unrestricted investments in non-utility ventures, what could occur is that the retained earnings that come from the regulated portion of the business are being reinvested not in the core business, but are being reinvested in non-core-related businesses. Therefore, that money is not available to write down overvalued assets. Overvalued assets are strandable costs.

Some of the registered holding companies as well as some of the exempt holding companies have significant exposure to strandable costs, as we know.

The problem is as you divert money from retained earnings and from other profits and funnel that money into non-utility ventures, it is no longer available to write down those overvalued assets and could result in causing consumers additional expense as an unintended consequence.

The CHAIRMAN. But, Mr. Frimerman, aren't you really talking about a much broader issue? You're talking about the entire area industry and what should or shouldn't be permitted under energy deregulation. That's not really what we are addressing here.

What you're doing is bringing in concerns—and I'm not saying they're not legitimate concerns—that are not addressed by PUHCA or the proposed legislation.

Indeed, we just heard Mr. LoBaugh testify as to what took place when Pacific Enterprises diversified, and you have very eloquently put forth your concerns, concerns which will have to be addressed. But this is not the forum in which to attempt to address these concerns. PUHCA does not deal with these problems.

It's not really fair to say that PUHCA is a problem, and there are a whole series of other problems, and you can't deal with any of them unless you do it comprehensively. We're not trying to deal with energy deregulation, we are trying to put authority into the hands of the proper regulators, the ones who know the issues and have been making the decisions.

Now, that's really where we're at.

What we have is people on both sides of the issue trying to pull extraneous issues in. It would be nice to deal with some of these issues to clean up problem areas, but it is not within the capacity or jurisdiction of this Committee.

Let me just say I do appreciate your testimony and the problems you address.

Mr. FRIMERMAN. If I could respond, Mr. Chairman.

The CHAIRMAN. Yes, certainly.

Mr. FRIMERMAN. Thank you. The concern is that it creates expanded opportunities for diversification and for investment which drains money from the holding company in and of itself. That is what the major problem with this is.

It's not that we are not sensitive to the need to adjust some of the financial reporting requirements, as well as some of the other requirements.

The CHAIRMAN. The arcane provisions? You don't care to use that word, do you?

Mr. FRIMERMAN. But—

The CHAIRMAN. Now, wait. He can't write that down. Your eyes flickered, for the record, but we don't know whether you agreed or didn't agree.

[Laughter.]

Mr. FRIMERMAN. Some of the provisions are not necessary. But some of the structural protections still remain necessary.

The CHAIRMAN. All right.

Dr. COOPER. Let me offer two observations quickly for the record.

The CHAIRMAN. Dr. Cooper.

Dr. COOPER. First, my lawyer friends are going to love this, but the series of activities that Mr. LoBaugh described, most of them you can do under PUHCA, if they can pass those standards.

The CHAIRMAN. Yes.

Dr. COOPER. He just doesn't want to do them that way. I will provide an explanation of them. We have a list of table and telephone and DSM and contiguous service territory, meter reading, all those other things, actually, that you can do under PUHCA.

Those corporations don't want to do them that way. But the public was not denied those benefits, to the extent that they may or may not exist. These companies just don't want to be subjected to that, and I'll get you the legal cites and explanations of how almost every one of those good things he stated that they would like to do, they actually can do under the law.

Second of all, in his case, he asserts that the rates in his company didn't go up. Well, maybe they should have gone down. For every example of a holding company structure that has protected consumers, I will get you an example of a holding company structure that put a lot of upward pressure on rates or held those rates higher because of that diversification.

It is interesting to hear companies step forward and say, I lost \$1 billion, and nobody got hurt but my stockholders. There are lots of companies that lost \$1 billion and rate-payers did get hurt.

The CHAIRMAN. Dr. Cooper, we could continue this discussion all day. Regarding diversification, we've seen that costs are not passed on to consumers, so how are consumers harmed by diversifications?

If anyone is hurt, it is the stockholders who should take the risk. In New York, Government stepped in when a utility company lost money. Instead of allowing the bondholders and the stockholders to absorb a multi-billion dollar loss, the Government interfered and the Governor, the State legislature, and the public service commissions agreed to pass the cost of a never-used plant on to the rate-payers. This fiasco is the result of the legislature trying to bail out the stockholders.

I think the stockholders, the people who choose to invest, should be at risk, not the rate-payers. I think, unfortunately, we see cases, especially at the State level, where the Government steps in and bails out the stockholders. In the case of the Long Island Lighting Company, the rate-payers were and are absolutely crippled.

It is the most incredible fiasco, and the media seems to be ignoring it. All anyone writes about now are the methodologies used to try to reform this broken system. Currently, we are to reduce the consumers rates, by up to 20 percent, by substituting the current bonds with tax-exempt bonds.

For the consumers, it would be some relief. However, we see people arguing about how the system got broken, arguing about what took place 10 years ago, instead of focusing on solutions. It is just incredible.

Dr. COOPER. Mr. Chairman, if you were to express those same sentiments when we debate the securitization, we're going to be on the same side because that's a specific example of a practice. But this is another problem.

The CHAIRMAN. Yes, but PUHCA didn't help the consumers on Long Island, it didn't help us at all.

Dr. COOPER. I've seen examples where, in the proprietary agreements to undertake new activities, the stream of revenues of the rate-payer is pledged. You can do that if you don't have PUHCA.

For the State regulator to find that the papers are in Philadelphia when you're in California, is tough. PUHCA doesn't let you do that. PUHCA gives you a place where you can go to say, here's the financing of that.

The CHAIRMAN. Doesn't the FERC provide that?

Dr. COOPER. It would not necessarily provide that under S. 621. The fundamental point is here is one place where we can go to look and find that.

Of course, how many orders are you going to give the FERC? I love the example of the FCC, which has the authority to audit the Baby Bells and the resources to accomplish it once every 17 years.

The fundamental question is, if you unleash these transactions, what happens if you don't have enough policemen and auditors to chase them around? That's our concern.

The CHAIRMAN. Dr. Cooper, nobody can argue with the fervor with which you express your beliefs. I appreciate your coming in and sharing them with us. I assure you that we will look at the issues which you raised.

I see that Mr. LoBaugh and Mr. Meyer both have a response. Mr. Tanski, go ahead. Then, I'll go to them.

Mr. TANSKI. To get back to the State review authority over the expenses of utility companies, we do agree that each State utility should have a right to review every dollar our utility commission spends. That includes affiliate transactions, if there are any.

But to then say, under S. 621, that the utility commission also should have the authority to go to our subsidiary in Houston to examine the books and records of our exploration and production subsidiary: If each State has the ability to do that, our concern is that we're going to be overwhelmed with these audit requests because they might say that that activity, that exploration and production activity, somehow affects consumer rates.

That's our concern with the bill as it's written. With discussions with your staff on that issue, I think we can probably work through that.

The CHAIRMAN. We'll look at that. I just want to remind you that the intent of the legislation is to ensure that you don't have one subsidiary overcharging and passing costs on to consumers through public utility rates. We'll take a look at the language to clarify that it does not authorize non-rate-related fishing expeditions.

Let's give Mr. Meyer and Mr. LoBaugh a chance to respond and then I believe Senator Faircloth has some questions.

Mr. Meyer.

Mr. MEYER. I yield to the Chair, then.

The CHAIRMAN. Make your point.

Mr. MEYER. I'll just make it quickly.

Dr. Cooper, I would just say, if we're talking about market concentration, all we can do now is buy an adjoining utility to which we can integrate, which only increases our market concentration in our given area. If we were able to buy utilities, such as Utilicorp can, in different parts of the country, that actually diminishes our concentration.

Also, the FERC has come up with its new rules now on market power that are so stringent in reviewing these mergers, that you're going to see a very careful control of market power.

I wanted to comment on one other thing, Mr. Chairman, and this really got me up out of my chair, and that is your comments about the risks that investors, shareholders, and bondholders took, and securitization.

We face a very real problem when utilities have invested in substantial properties that are used and useful—Shoreham never got to the used and useful part—

The CHAIRMAN. No.

Mr. MEYER. —that have been found prudent by these State commissions and now suddenly, they don't want to include them any longer in rate base because they have some definition of excess cost over market.

We have a statement by a single Texas commissioner made in March 1997, that she did not feel that she had to honor that commitment any longer, which is written into law in Texas, and the largest investor-owned utilities in Texas have now lost \$4 billion in market value.

I think there's a real argument of equity, if not law, involved in that situation.

The CHAIRMAN. I agree, I think Government has a responsibility to honor contracts, particularly where the prudent man standard has been observed.

Unfortunately, in the case of LILCO, that standard was not held. It ended up being a catastrophe for rate-payers.

Mr. MEYER. That was different.

The CHAIRMAN. As you indicated.

Mr. MEYER. It never operated.

The CHAIRMAN. To stick the rate-payers with the cost was just unconscionable. The former Governor is getting a free ride on that.

But, of course, the legislature went along with the plan without concern for the rate-payers because they were so happy to close the plant down.

Mr. MEYER. We would love to be invited back, but I'm not sure this Committee is where we're going to talk about securitization and some of these other issues. I know you'll be a leader in that debate, though, and I hope you are.

The CHAIRMAN. Mr. LoBaugh, I think you wanted to say something. Then, we will go to Senator Faircloth.

Mr. LOBAUGH. I was just going to comment on, I believe it was Dr. Cooper's comment about the revenue flow from utilities.

I wasn't quite sure exactly what Dr. Cooper was referring to. But I know in California and several of the other States, at least the ones I'm familiar with, the utility State commissions have the capacity to intervene in the dividend flow from utilities, for instance, to a holding company, if there's any evidence in their opinion that there's a financial detriment to the underlying utility. That's certainly true in California and I know in several other States.

In addition, you have circumstances like in California, for example, where you cannot pledge general utility assets for non-utility activities without a prior approval by the PUC. To my knowledge, at least certainly in our activities in the last 20-some years I practiced law there in California, I don't ever recall having seen that even be requested, let alone approved. To do so without that prior approval constitutes a criminal violation in California. It's taken quite seriously.

There are a lot of ways in which the States can deal with those issues very effectively. It is certainly not a Federal pre-emption issue and it has nothing to do with PUHCA.

The CHAIRMAN. Senator Faircloth.

Senator FAIRCLOTH. Mr. LoBaugh pretty much answered what I was going to ask, about the firewall or whatever between the utilities and the outside ventures.

Out of curiosity, which did you lose the most money on?

Mr. LOBAUGH. Drug stores.

Senator FAIRCLOTH. Drug stores? I would have thought farming. [Laughter.]

Mr. LOBAUGH. No. Ironically, in farming, we made money. At one point, we even had an immense amount of the world's population, the production of pistachio nuts. We never made any money there, however. But in the rest of the area, we did make substantial money.

We got out of farming for a variety of reasons. The return wasn't that great, there were some environmental concerns, and as the issues associated with the labor movements, et cetera, started to rise in California, the board directed us to liquidate or sell the farming assets. We did so at a profit.

Senator FAIRCLOTH. You say you did not raise rates. Without this outside loss, businesses beyond your utility, normal business, could you have reduced rates if you had not had a \$1 billion loss?

Mr. LOBAUGH. No. They had nothing to do with the rates of the utility. The utility rates in California start with the basic investment in the utility plant. You receive your debt cost. You receive a proposed return on that.

The gas costs, per se, are basically flow-through costs. You have your O&M charges that are associated with the operation and outside contracts.

Any inter-affiliate transaction, which for us was primarily those of corporate services such as the lawyers, are examined by the commission. They even go so far as to check our timesheets. We keep timesheets for every 15 minutes, like a law firm would, and those are reviewed and audited and the costs are checked.

So, no, it had no impact and would not have had any impact on the utility.

I think there's a perverse incentive where capital is not available for utilities to go elsewhere, though. I'm not familiar with any utilities that have done this, but I've read that there is an incentive to reinvest capital back in the utility, if that's your sole place for earning.

The name of the game before competition was basically the idea that you enlarged your rate base. The more capital you funneled back into that utility, the more earnings the corporation achieved.

There is a perverse incentive there that is inconsistent with one of the comments made by the earlier commentators.

The CHAIRMAN. Dr. Cooper is going wild now.

Dr. COOPER. Let me make a positive suggestion.

Senator FAIRCLOTH. Just a minute.

In running the State utility commission, we found that happening a great deal of the time, excess spending in the utility because the more they spent, the more they got back. I followed that practice for 7 years.

Thank you.

The CHAIRMAN. Dr. Cooper.

Dr. COOPER. California is a State with a fairly potent holding company law. It might do the Committee well to look at the potency of that law because I guarantee you, the other 49 States, not all of them are there. Actually, most of them are not even close.

If we are going to invoke these tremendous powers of California as the backstop, the answer is to have those protections elsewhere. California is a pretty big commission with lots of resources and gets after its utilities.

Second of all, this question of the \$1 billion loss, where did the capital come from? It probably came from the cash-flow generated by the operating companies.

One of the things that happens, particularly within telephone companies and also within exempt holding companies, if you generate all of this free cash—and that's what it's called in the banking community—if you can't bury it somewhere, if you can't buy drug stores and so forth, it starts to build up within the utility.

What tends to happen is you declare very fat dividends and regulators suddenly discover, hey, maybe rates are too high because the total return to investors start to go real big if you can't shovel cash out the door somewhere else.

You can say this was cash generated by the operating company, but it was returned of and on capital and therefore, it had no effect on rates. If you can't funnel it somewhere else, it has this tendency to embarrass regulators because it builds up, increasing a return.

One of the problems of divestiture, and it's quite clear in the telephone industry, is the operating companies have been generating humongous sums of cash that have been funneled out into unregulated businesses. Then we complain that, if that opportunity hadn't been there, our rates could have gone down.

Mr. MEYER. That is a basic misunderstanding of the economic system.

The CHAIRMAN. This is a wonderful debate.

Mr. MEYER. That cash belonged to the shareholders, who got it back and hopefully, by installing management, management will decide what will be invested, Dr. Cooper.

Dr. COOPER. Under a regulated utility, you have a return which must be reasonable commensurate with risk. If there is too much cash generated, then rates are too high and ought to come down.

The CHAIRMAN. But, Dr. Cooper, isn't that really one of the problems inherent in a monopoly system, where franchises are granted and where you do have the regulation of capital return?

In fairness to your observation, I think you make a good point. But these are broad issues and problems with regulated monopoly systems.

I don't know how to solve these problems, and I think they are part of the big picture of energy deregulation, but they are undeniably issues that need answers.

Dr. COOPER. The mixed enterprise is what creates the problem, partially regulated, partially unregulated, and how the cash flows within that.

The CHAIRMAN. Senator Faircloth stated this problem well—and I saw it for years in the State of New York, where the regulated utilities did not care and poured more and more and more money into their affiliates because they got their return from the State

based on the profit of the core business. That's how that Shoreham monster came about.

If the public service commission in New York did not grant rate increases based on core business profit, LILCO would have never put billions and billions into that monster.

So the system encouraged that kind of situation. You are right, until the rate system changes or there is true competition, there will be an incentive for utilities to minimize the rate of return.

Let me say this to you, because we could continue this debate all day, that while the concerns you raise are reasonable, they belong to the broader debate on energy deregulation.

I also want to say to Dr. Cooper, Mr. Frimerman, and Mr. Tanski, that I would welcome your input as it relates to suggested legislative proposals to make S. 621 a better bill. I'm not saying we will take all the suggestions, but we are interested in looking at anything you have to offer. Both the Majority and Minority counsels are working on this. This is a bipartisan effort with broad support.

I want to say, again, that I would like to move this quickly. I know there are Members of this Committee who feel much stronger than I do with respect to this legislation. But I would like to see that the legitimate concerns on all sides are addressed so that this bill is as strong as possible as it moves forward.

I would suggest you contact the Committee counsels. They stand ready to meet with you.

I thank all the witnesses for participating today, and we welcome your suggestions.

Senator Faircloth, do you have any final comments you would like to make before we adjourn?

Senator FAIRCLOTH. No. Thank you.

The CHAIRMAN. We stand in recess.

[Whereupon, at 12:00 noon, the Senate Banking Committee was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR ALFONSE M. D'AMATO

Later this week, this Nation will unveil a new monument to a great New Yorker and former President, Franklin Delano Roosevelt. As father of the New Deal, FDR's legislative legacy has dominated America for the last 60 years. Now, as we stand on the edge of the new millennium, it is time to rethink laws which no longer meet the test or needs of modern times. As we celebrate a new structure on the Mall, it is now time to reform an old one—the structure of public utility holding company regulation.

Today the Committee will consider reform of the Public Utility Holding Company Act of 1935; including S. 621, the "Public Utility Holding Company Act of 1997." This bipartisan bill is identical to legislation the Committee reported last Congress.

S. 621 would repeal PUHCA and would eliminate the SEC's role as the primary regulator for 15 registered public utility holding companies, giving that regulatory authority to the States and to the FERC.

As both the Chairman and Ranking Member of the Senate Energy Committee—Senators Murkowski and Johnston—testified last year, PUHCA repeal is necessary "to streamline regulation, promote competition, and protect utility customers." I would like to thank Senator Murkowski for appearing before this Committee again this year.

S. 621 would accomplish two critical goals—it would improve consumer protection and make the energy industry more competitive.

The bill would improve consumer protection by making it easier for State and Federal regulators to make sure consumers don't pick up the tab for expenses that have nothing to do with the energy services they receive. S. 621 would ensure that utility companies set fair rates by allowing the regulators to have more access than they have today to inspect the books and records of the utility company and all of its affiliate companies.

Transferring all regulation of utility holding companies to the energy regulators would consolidate regulation, making the regulators more efficient and effective. It would also streamline regulation for registered utility companies and create a level playing field between registered and exempt holding companies.

Overall, S. 621 creates a better and less burdensome system benefiting both consumers and businesses. S. 621 would knock down antiquated barriers to competition and facilitate deregulation.

The States have already taken steps to deregulate the energy industry. My own State of New York approved a plan for deregulation last year. The plan allows New Yorkers—who pay some of the highest electricity rates in the country—to choose their power provider, just as they can choose their long distance telephone company. More competition will ultimately mean cheaper rates for consumers.

While my distinguished colleagues on the Energy Committee continue their work on a comprehensive energy bill, PUHCA repeal can and should go forward now.

As FDR once said, "There is nothing I love as much as a good fight." I have been fighting to reform PUHCA for many years and I thank my colleagues for joining me in this fight. I thank the cosponsors of the bill, Senator Murkowski, from the Committee on Energy and Natural Resources, and on this Committee: Senators Dodd, Sarbanes, Gramm, Shelby, Mack, Faircloth, and Allard.

S. 621 represents a bipartisan effort, developed in consultation with State and Federal regulators and the private sector. I hope that today's hearing will enable the Committee to report soon a bill that protects customers and is good for business.

I look forward to hearing the witnesses testimony.

PREPARED STATEMENT OF SENATOR CHRISTOPHER J. DODD

Thank you very much, Mr. Chairman, for scheduling today's hearing on S. 621, the Public Utilities Holding Company Act of 1997. I am very pleased to be an original cosponsor of this legislation which, when enacted, will remove some archaic and unnecessary barriers to competition in the energy industry.

There is little doubt that "PUHCA" is one of the more obscure laws under the jurisdiction of this Committee, yet it's important to recognize that when it was originally enacted, in 1935, it was one of the most important securities laws created as part of the New Deal reforms that followed the financial catastrophes of the Great Depression.

Nor should we forget that PUHCA was enacted primarily as investor protection law, not as rate-payer protection law. That's why administration of the statute was placed and kept within the Securities and Exchange Commission, rather than in the FERC's predecessor, the Federal Power Commission.

Today, many of PUHCA's requirements have been rendered obsolete by the success of other Federal securities laws and by the successful regulation of the energy industry by State and Federal authorities. Of course, at the time PUHCA was enacted, over 60 years ago, these other statutes and regulatory bodies were either in their infancy or did not even exist.

In light of the maturation of both securities and utility regulation, it is now appropriate to ask ourselves if the specific restrictions contained in PUHCA are still necessary.

Careful consideration of the issue leads me to agree with the SEC that the answer is "no." That is why I am very pleased to be an original cosponsor of S. 621, which will repeal the archaic sections of PUHCA and transfer regulatory authority over the remaining utility holding companies from the SEC to the FERC, where it rightly belongs.

Let me cite just one provision of PUHCA that demonstrates how anachronistic this law has become. Unlike any other industry in America, the registered holding companies were required to seek SEC approval before they issue or sell securities. This is clearly an outdated and unnecessary statutory provision—which applies to no other group of companies in the country. While the SEC has long recognized, through regulatory action, that this is an outmoded requirement, it is high time for Congress to arrive at the same recognition and remove from the books these statutory restrictions that made sense in 1935, but make little sense today.

Mr. Chairman, the legislation under consideration today is the result of a diligent effort by this Committee to work with the SEC, the FERC, and State utility commissioners to fashion a bill which would first ensure that the FERC and the States maintain all the tools necessary to fully regulate the utility holding companies while eliminating the barriers to competition.

Last year, the result of that effort, S. 1317, was passed by this Committee with the support of all three of those regulatory bodies—no mean feat. S. 621 is virtually identical to that legislation and I hope that we can move with all due speed to a markup of it.

I would like to address one final point, Mr. Chairman, before we turn to our three panels of distinguished witnesses.

Ever since we embarked on this effort to repeal PUHCA, my office has heard from those interests who, while expressing no substantive disagreement with the legislation, urge this Committee to delay action until such time when Congress considers a gargantuan energy deregulation bill. Those interests see PUHCA repeal just as a bargaining chip they can use to extract concessions on issues that fall outside the jurisdiction of our Committee.

I, for one, have never been a fan of making the enemy of the good; nor am I supportive of failing to take one significant step forward in the hope of trying to leap a record 20 steps forward instead.

Mr. Chairman, I believe the evidence and the hearing record will clearly demonstrate that there are ample regulatory and statutory structures in place to fully protect both investors and rate-payers without forcing these companies to endure the expense and burden of complying with this outdated statute.

I applaud you for pushing this initiative, and look forward to working with you on its eventual passage.

PREPARED STATEMENT OF SENATOR WAYNE ALLARD

Thank you, Mr. Chairman, for holding this important hearing on the conditional repeal of the Public Utilities Holding Company Act. As you know, I am a cosponsor of this legislation. This legislation does what we need to do more, it consolidates regulation and eliminates duplication. But it is also important to point out that this legislation retains many consumer protections.

The Securities and Exchange Commission, the agency which enforces this Act, recommends that this legislation be approved. This is instructive, since it is so rare that a Federal agency recommends that its regulatory authority be curtailed.

I mentioned that this legislation constitutes conditional repeal. Under the legislation, much of the authority held by the SEC is transferred to the Federal Energy Regulatory Commission (FERC) and to the State utility regulators. The SEC already defers to the FERC for the key decisions under PUHCA.

I know there is opposition to this legislation. However, this opposition appears to focus on the timing and the context of repeal.

I am sure there may be ways to improve this legislation, and I look forward to working with the Chairman in this process.

PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

Thank you, Mr. Chairman, for holding this hearing. I appreciate all the work you and Members of the Committee on Energy and Natural Resources have done. Notwithstanding your previous efforts, I believe this legislation is past due and I urge the markup of this bill as quickly as possible.

The Public Utility Holding Company Act of 1997 is basically the very same bill we reported out of Committee last year after working closely with the Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the State's Public Service Commissions. Based on their recommendations and the changes we made last year, I believe we have a bill that can and should be signed into law.

The current application of a 1935 law to 20 percent of the market causes an unfair competitive advantage to those companies that are exempt from the Act. In the interest of competition, and thus the consumer, we need to repeal the antiquated Public Utility Holding Company Act. The freedom and the flexibility incorporated in the Public Utility Holding Company Act of 1997 are necessary for the industry to remain competitive in the ever changing market environment. Indeed, PUHCA repeal will allow utilities to provide better services to consumers at lower prices.

Mr. Chairman, I support your efforts, and again thank you for your diligent work on this issue.

PREPARED STATEMENT OF FRANK H. MURKOWSKI

A U.S. SENATOR FROM THE STATE OF ALASKA AND
CHAIRMAN OF THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
APRIL 29, 1997

Mr. Chairman and Members of the Committee, thank you for allowing me to testify in support of this legislation. I want to commend Chairman D'Amato for introducing this bill, and the Members of this Committee who are cosponsors. Repeal of PUHCA is the right thing to do: It is pro-consumer and pro-competition.

As you are aware, the electric power industry is undergoing dramatic change, and is seeking ways to become even more competitive. This is driven by the recognition of everyone that competition benefits consumers. If there is to be robust competition, we must get rid of unnecessary Federal constraints that prevent companies from adapting quickly and responding flexibly to changing market circumstances. That is exactly what PUHCA prevents—and why PUHCA must go.

When we talk about PUHCA repeal, we always think first about how it restricts and limits the 15 registered electric and gas utility holding companies. But that is just a small part of the story. PUHCA also limits and restricts the competitive activities of hundreds of PUHCA-exempt utilities and the numerous non-utilities, all of whom want to participate fully in the electric power market. These companies won't take a variety of pro-competitive actions out of fear of becoming classified as a registered holding company. To them it's not worth getting tangled in PUHCA's sticky web of restrictions and requirements.

Congress has long recognized that PUHCA creates competitive problems, but so far we have addressed them only on a piecemeal basis. For example:

- In 1978, Congress gave an exemption from PUHCA to help promote certain types of electric power generators.
- In 1986, Congress created an exemption from PUHCA to allow the registered gas utility holding companies to own gas-fired co-generation facilities.
- In 1992, the Energy Policy Act gave an exemption from PUHCA to the so-called "exempt wholesale generators."
- In 1996, Congress gave registered utility holding companies a PUHCA exemption so that they could fully participate in telecommunications.

In 1995, after conducting a year-long study of the electric utility industry, the Securities and Exchange Commission reported that the public interest is no longer served by PUHCA. The SEC recommended its repeal. The bill before the Committee today is a direct outgrowth of the SEC's report and recommendations to Congress.

Some have claimed that this legislation will create a "regulatory gap" that will allow consumers to be harmed. That is simply not true. Over the past 60 years, a comprehensive State-Federal regulatory system has been developed. State public utility commissions regulate *retail* electric rates under State law, the Federal Energy Regulatory Commission regulates *wholesale* rates under Federal law, the SEC has broad powers to regulate securities under laws other than PUHCA, and we have the Federal Trade Commission, the U.S. Department of Justice, and State attorneys general to deal with anti-competitive behavior.

As I am sure you will agree, this legislation does not, nor is it intended to, allow utilities to evade appropriate regulation at the Federal and State level. I believe in conjunction with other existing Federal and State consumer protection laws, this legislation allows the full protection of consumers. The bill before the Committee is the result of improvements suggested by the FERC, by State utility commissioners, by consumer groups, and others to the legislation introduced in the last Congress. But, having said that, like you, I am open to improvements to the bill's consumer protection provisions so long as they are within the context of the legislation.

Just as you did last year, today you may hear from some that Congress should act on this bill only as a part of "comprehensive" legislation to restructure the entire electric power industry. You may also hear from others who want to use this bill as a vehicle to move highly controversial matters, such as Federal pre-emption of the States, Federally-ordered retail wheeling, or mandatory utility breakup. You should reject those calls. This legislation can, and should, proceed on a stand-alone basis. These other issues are not linked to action on PUHCA repeal. Pro-consumer PUHCA reform must not be held "hostage" to unacceptable proposals. Each should rise or fall on their own merits.

Some have also asserted that PUHCA should not be repealed because of concerns about "market power" and fears that we will see a few large companies dominating the electric sector. This assertion is based on fears, not facts. First, it ignores the fact that the FERC and State public utility commissions must approve any merger before it can take place. If either the FERC or a State regulator finds that a utility merger is not in the public interest, they can require the merging companies to take certain actions, or they can simply reject it. Second, the generation and wholesale transmission segments of the electric power industry are already competitive; the FERC's open access transmission rule is working. Third, even if PUHCA is repealed, the FERC and the State public utility commissions will continue to have jurisdiction over the transmission and distribution of electricity, as well as over retail rates to consumers.

As you may be aware, the Energy Committee is holding a comprehensive series of hearings and workshops on competitive change in the electric power industry. Six were held last Congress. Three have been held so far this year, and three more have been scheduled. Through this process, the Energy Committee will determine what changes, if any, are necessary to the utility laws that are jurisdictional to our Committee. The Energy Committee will continue this process and we will legislate if and when we are convinced that the legislation will benefit consumers, as will PUHCA repeal.

In conclusion, PUHCA is a 60-year-old statute that was designed to cure the problems of a now long-gone, Depression-era industry structure. Having done its job, it is time to retire PUHCA.



TESTIMONY OF

**ISAAC C. HUNT, JR., COMMISSIONER
U.S. SECURITIES AND EXCHANGE COMMISSION**

**REGARDING S. 621, A BILL TO REPEAL THE
PUBLIC UTILITY HOLDING COMPANY ACT OF 1935**

**BEFORE THE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE**

APRIL 29, 1997

U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Summary

The Securities and Exchange Commission (SEC) supports S. 621 and the goals that it seeks to achieve. The bill would repeal the Public Utility Holding Company Act of 1935 (1935 Act) and establish a less pervasive framework for regulation of public utility holding companies, thereby eliminating provisions that duplicate other Federal and State regulation while, at the same time, preserving important protections for consumers. The bill is consistent with most of the key elements of the recommendations of the SEC concerning the future regulation of public utility holding companies.

The 1935 Act was enacted to address and correct abusive practices that had developed in the electric and gas utility industry in the first quarter of the century, to the detriment of investors, consumers, and the public interest. However, the 1935 Act has become redundant in many respects, as a result of prudent administration of the statute and the development and evolution of other State and Federal regulation. Moreover, the regulation contemplated by the Act to address the problems of a different era may prevent companies from responding effectively to the changes now occurring in the utility industry.

The SEC staff, at the direction of Chairman Arthur Levitt, undertook a study of the regulation of public utility holding companies in the summer of 1994. The study culminated in a June 1995 report of the SEC staff that proposed a range of legislative and administrative measures to eliminate unnecessary regulatory burdens on public utility holding company systems.

The SEC recommended that Congress consider three legislative options, based on the analysis and conclusions contained in the report. The preferred option is repeal of the 1935 Act, accompanied by the creation of additional authority at the State and Federal level to permit the continued protection of consumers through examination and oversight of transactions between or among holding company affiliates by the Federal Energy Regulatory Commission (FERC), and through access to books and records by the FERC and State utility commissions. The SEC believes conditional repeal is a preferred course of action because it would achieve the economic benefits of unconditional repeal, and yet also preserve the ability of States to protect consumers.

S. 621 largely implements the option recommended by the SEC, by providing the FERC and the State regulators with broad authority to inspect books and records of companies in holding company systems. The bill does not, however, adopt the SEC's recommendation that the FERC have discretion to exercise jurisdiction over affiliate transactions, including prior review and approval of such transactions in appropriate circumstances. The SEC continues to believe that such authority is necessary to shield consumers from the potential abuses that may be involved in affiliate transactions.

Testimony

Chairman D'Amato and Members of the Committee, I am pleased to have this opportunity to testify before you on behalf of the Securities and Exchange Commission (SEC) and to express support for S. 621. By repealing the Public Utility Holding Company Act of 1935 (1935 Act) and establishing a less pervasive framework for Federal regulation of public utility holding companies, the bill would eliminate duplicative regulation while also preserving important protections for customers of utility companies in multi-state holding company systems. The legislation incorporates most of the SEC's recommendations with respect to the future of public utility holding company regulation. As was the case with the bill's predecessor, S. 1317, the SEC shares the concerns addressed by the legislation and supports the goals that it seeks to achieve.

I. Introduction

The electric and gas utility industry had developed serious problems in the first quarter of the century through the misuse of the holding company structure.¹ The 1935 Act was enacted to address these problems. Reorganization and simplification of existing public utility holding companies in order to eliminate those abuses was a major part of the SEC's work in the years following passage of the 1935 Act.

¹These abuses included inadequate disclosure of the financial position and earning power of holding companies, unsound accounting practices, excessive debt issuances, and abusive affiliate transactions. See 1935 Act section 1(b), 15 U.S.C. § 79a(b).

In the early 1980's, the SEC unanimously recommended that Congress repeal the statute.² The SEC concluded that the 1935 Act had accomplished its basic purpose and that its remaining provisions, to a large extent, either duplicated other State or Federal regulation or otherwise were no longer necessary to prevent recurrence of the abuses that led to its enactment. Many aspects of 1935 Act regulation had become redundant: State regulation had expanded and strengthened since 1935, and the SEC had enhanced its regulation of all issuers of securities, including public utility holding companies. In addition, institutional investors such as pension funds and insurance companies had become much more sophisticated and had demanded more detailed information from all issuers of securities than that which was previously available. Changes in the accounting profession and the investment banking industry also had provided investors and consumers with a range of protections unforeseen in 1935.

Because the potential for abuse through the use of multi-state holding company structures, and related concerns about consumer protection, continued to exist, and because of a lack of consensus for change, repeal legislation was not enacted in the early 1980's. Since that time, however, the SEC has continued with its effort to administer the 1935 Act flexibly to accommodate developments in the industry while still adhering to the basic purpose of the statute. In addition, Congress has created a number of statutory exceptions to the regulatory framework of the 1935 Act.³

II. The SEC's Study

In response to continuing changes in the utility industry in recent years, and the accelerated pace of those changes, Chairman Arthur Levitt directed the SEC's Division of Investment Management in 1994 to undertake a study, under the guidance of then-Commissioner Richard Y. Roberts, to examine the continued vitality of the 1935 Act. The study was undertaken as a result of the developments noted above and the SEC's continuing need to respond flexibly in the administration of the 1935 Act. Its purpose was to identify unnecessary and overlapping regulation, and at the same time to identify those features of the statute that remain appropriate in the regulation of the contemporary electric and gas industries.⁴

The SEC staff worked together with the representatives of the utility industry, consumer groups, trade associations, investment banks, rating agencies, economists, State, local, and Federal regulators, and other interested parties during the course of the study. In June 1995, a report of the findings made during the study (report) was issued. Based on these findings, the SEC has recommended, and continues to recommend, that Congress repeal the 1935 Act. At the same time, however, the SEC also recommends enactment of legislation in order to provide necessary authority to the FERC and the State public utility commissions relating to affiliate transactions, audits, and access to books and records, for continued protection of utility consumers.

There are several reasons why the SEC supports conditional repeal of the 1935 Act. As the report indicates, portions of the 1935 Act, governing the issuance of securities, acquisition of other utilities, and acquisition of non-utility businesses by registered holding companies, largely duplicate other existing regulation and controls imposed by the market. Nevertheless, there is a continuing need to ensure the protection of consumers.

Electric and gas utilities have historically functioned as rate-regulated monopolies, and there is a continuing risk that a monopoly, if left unguarded, could charge higher rates and use the additional funds to subsidize affiliated businesses in order to boost its competitive position in other markets (cross-subsidization). So long as electric and gas utilities continue to function as monopolies, the need to protect against the cross-subsidization of non-utility businesses will remain. The best means

² See *Public Utility Holding Company Act Amendments: Hearings on S. 1869, S. 1870, and S. 1871 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 97th Cong., 2d Sess. 359-421 (1982) (statement of SEC).

³ Most recently, Congress enacted the Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56 (1996). The Telecommunications Act permits registered holding companies, without prior SEC approval under the Act, to acquire and retain interests in companies engaged in a broad range of telecommunications activities.

⁴ The study focused primarily on registered holding company systems, of which there are currently 15. The 1935 Act was enacted to address problems arising from multi-state operations, and reflects a general presumption that intra-state holding companies and certain other types of holding companies which the 1935 Act exempts and which now number more than 100, are adequately regulated by local authorities. Despite their small number, registered holding companies account for a significant portion of the energy utility resources in this country. As of December 31, 1996, for example, these companies owned more than \$126 billion of electric utility assets, approximately 21 percent of all assets owned by investor-owned electric utilities.

of guarding against cross-subsidization is likely to be audits of books and records and Federal oversight of affiliate transactions.

Utility rates are regulated by State authorities, and some regulators subject these rates to stricter scrutiny than others. A survey of State regulation, undertaken in conjunction with the study, revealed that the States may not have adequate authority to perform audit and review functions with respect to multi-state holding companies. The provisions of the 1935 Act provide significant assistance to these States in their effort to protect utility consumers. Earlier efforts to repeal the 1935 Act may have failed because they did not address this potential "regulatory gap" in consumer protection.

III. S. 621

S. 621 would provide the FERC with the right to examine books and records of registered holding companies and their affiliates that are relevant to costs incurred by associated utility companies, in order to protect the rate-payers. The legislation would also provide an interested State commission with access to such books and records (subject to protection for confidential information), if they are relevant to costs incurred by utility companies subject to the State commission's jurisdiction and are needed for the effective discharge of the State commission's responsibilities in connection with a pending proceeding. Finally, the bill would provide a transition period in which the States, utilities, and other parties affected by the change in the regulatory regime could prepare for the new regime. The bill, like its predecessor, S. 1317, accomplishes many of the goals of the conditional repeal contemplated by the SEC.

S. 621 does not give the FERC the authority it needs in order to oversee transactions among affiliates in holding company systems and, in this one respect, does not reflect the SEC's preferred legislative option. The bill's provisions granting access to books and records provide the FERC and the State commissions with the authority they need to identify affiliate transactions and their terms and effects on utility costs and rates. However, the potential still remains for cross-subsidization and consequent detriment to consumers, and the SEC believes it is important for the FERC to have the flexibility to be able to engage in more extensive regulation, if necessary. As a result, the SEC continues to support a broader grant of authority to the FERC to oversee these transactions, including, if the FERC deems it appropriate, prior review and approval of affiliate transactions.

The SEC notes that the report recommended a transition period of at least 1 year in duration. The National Association of Regulatory Utility Commissioners has since suggested that a longer period is necessary, in view of the fact that many State legislatures only meet once every 2 years. The SEC would have no objection to a longer transition period.

IV. Other Recommendations

Two other legislative options were recommended by the SEC staff report: complete repeal of the 1935 Act and a grant of broader exemptive authority under the Act to the SEC.

The SEC believes that complete repeal, the second recommended legislative option, is premature, because of the remaining industry monopoly power and the inconsistent pattern of State regulation described above. Some commentators contend, however, that the States have the ability, if they choose to exercise it, to create regulatory structures that will protect utility consumers in holding company systems to the same extent as they are protected by the 1935 Act. Complete repeal, like conditional repeal, would require a reasonable transition period. As noted above, some States may need a period of at least 2 years to enact new legislation or to add resources to meet the additional regulatory burden that would accompany unconditional repeal of the 1935 Act.

The third option is to provide the SEC with more authority to exempt holding company systems from the requirements of the 1935 Act.⁵ An expansion of exemptive authority would not, of course, achieve the economic benefits of conditional or

⁵The SEC's current exemptive authority is considerably narrower than the exemptive authority under other Federal securities laws. A model of broader exemptive authority is contained in section 6(c) of the Investment Company Act of 1940, 15 U.S.C. § 80a-6(c), which grants the SEC the authority by rule or order to exempt any person or transactions from any provision or rule if the exemption is necessary or appropriate in the public interest and consistent with the protection of investors. See also section 206A of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6a; and section 36 of the Securities Exchange Act of 1934, as recently amended by the National Securities Markets Improvement Act of 1996, 15 U.S.C. § 78mm (same).

unconditional repeal of the 1935 Act, or simplify the Federal regulatory structure.⁶ Further, this option would continue to enmesh the SEC in difficult issues of energy policy.

The SEC is also aware that proposals for comprehensive reform of energy legislation are under consideration by Congress. Repeal of the 1935 Act could also be considered as part of this overall reform.

V. Administrative Action

The SEC continues to support a comprehensive approach to reform of the 1935 Act, such as that reflected in S. 621. Pending congressional action, however, the SEC has begun to implement many of the numerous administrative initiatives that were recommended in the report to streamline regulation.⁷ Despite the effects of these initiatives, changes in the utility industry are resulting in increased activity under the 1935 Act, in the areas of mergers and acquisitions, diversification, and affiliate transactions, for example, and continuation of the 1935 Act in its present form will require additional resources.

The options of conditional repeal or an expansion of the SEC's exemptive authority also raise the issue of resources. At present, there are 16 full-time professional SEC employees employed in the administration of the 1935 Act. Their work includes (1) analysis and disposition of various transactions for which the 1935 Act requires prior SEC authorization, (2) status issues under the 1935 Act, (3) audits of holding company systems and related companies, and (4) drafting and implementation of rulemaking proposals to reflect changes in the utility industry and in financial regulation. Repeal of the 1935 Act would not achieve significant cost savings for the Federal Government, particularly if some of these responsibilities were carried out by the FERC. Expanded exemptive authority, on the other hand, could require greater resources, in view of the need to evaluate and implement broad requests for exemptive relief.

VI. Conclusion

The SEC takes seriously its duties to administer faithfully the letter and spirit of the 1935 Act, and is committed to promoting the fairness, liquidity, and efficiency of the U.S. securities markets. By supporting conditional repeal of the 1935 Act, the SEC hopes to reduce unnecessary regulatory burdens on America's energy industry while providing adequate protections for energy consumers.

⁶In the past, the SEC has testified before Congress with respect to concerns that arose after the decision by the U.S. Court of Appeals for the District of Columbia Circuit in *Ohio Power v. FERC*, 954 F.2d 779 (D.C. Cir.), cert. denied, 113 S.Ct. 483 (1992). See *Registered Holding Company Transactions: Hearing on the 1992 Ohio Power Decision Before the Subcomm. on Energy and Power of the House of Representatives Comm. on Energy and Commerce*, 103d Cong., 2d Sess. 35-48 (1994) (testimony of Richard Y. Roberts, Commissioner, SEC). The legislative repeal options discussed above would eliminate the problem of conflicting SEC and FERC decisions that was the subject of that decision. Enhanced exemptive authority would not address such problems unless the SEC, through the exercise of its exemptive powers, were to cease issuing orders affecting the pricing of goods.

⁷The report recommended rule amendments to broaden exemptions for routine financings by subsidiaries of registered holding companies (see Holding Co. Act Release No. 26312 (June 20, 1995), 60 FR 33640 (June 28, 1995)) and to provide a new exemption for acquisition of interests in companies that engage in energy-related and gas-related activities (see Holding Co. Act Release No. 26313 (June 20, 1995), 60 FR 33642 (June 28, 1995) (proposing rule 58) and No. 26667 (Feb. 14, 1997), 62 FR 7900 (Feb. 20, 1997) (adopting rule 58)). In addition, the report recommended changes in administration of the Act that would permit a "shelf" approach for approval of financing transactions, relax constraints on utility acquisitions, and streamline the approval process for such transactions. The report also recommended an increased focus upon auditing regulated companies and assisting State and local regulators in obtaining access to books, records, and accounts.

PREPARED STATEMENT OF SUSAN TOMASKY
GENERAL COUNSEL, FEDERAL ENERGY REGULATORY COMMISSION
APRIL 29, 1997

Mr. Chairman and Members of the Committee, it is a pleasure to be here this morning to discuss S. 621, the Public Utility Holding Company Act of 1997, introduced April 22, 1997.

Under current law, the two major Federal statutes affecting electric utilities are the Holding Company Act and the Federal Power Act (FPA). Both were enacted as part of the same legislation in 1935, in order to curb widespread financial abuses that harmed electric utility investors and electricity consumers. While there is overlap in the matters addressed by these Acts, they each have different public interest objectives. The areas of overlap are thoroughly described in testimony submitted last year to this Committee by the Chair of the Federal Energy Regulatory Commission, Elizabeth A. Moler. I will not repeat that testimony today.

In her testimony before this Committee, Chair Elizabeth Moler deferred to the expertise of the Securities and Exchange Commission (SEC), which administers the Holding Company Act, as to whether the Holding Company Act should be repealed. The SEC's substantial review of the ongoing need for the Act, described in its June 1995 report, "The Regulation of Public Utility Holding Companies," led that Commission to ask Congress to conditionally repeal the Act and enact certain rate-payer safeguards in its place. We agree with a fundamental premise of the SEC's report that rate regulation at the Federal and State level has become the primary means of ensuring rate-payer protection against potential abuse of monopoly power by utilities that are part of holding company systems.

This is a time of enormous change for the electric utility industry. It is entirely appropriate for Congress to reexamine the framework for regulating electric utilities, so that unnecessary restrictions on corporate activities can be eliminated. Some restrictions under the Holding Company Act can limit the ability of companies to pursue otherwise appropriate business strategies in response to emerging competition in generation markets.

At the same time, as utilities diversify and enter competitive businesses, the need to protect adequately against affiliate abuse becomes all the more significant. Rate-payers need to be protected against unfair charges for goods and services provided to utilities by their unregulated affiliates. Proper cost allocation is also essential—both to ensure that rate-payers do not bear the costs of non-utility business activity and to ensure that utilities do not enjoy an unfair advantage in competitive markets by virtue of improper rate-payer subsidies.

From a rate-payer protection point of view, we believe the Holding Company Act can be repealed without jeopardizing consumer protection, so long as certain issues are adequately addressed. In her testimony, Chair Moler identified these issues:

- First, the regulatory gap created by the 1992 *Ohio Power* court decision should be closed. The FERC authority over affiliate transactions within registered holding company systems—authority that is impaired by the *Ohio Power* decision—should be restored.
- Second, exemptions from the new Act should be crafted narrowly. While it may be appropriate to grandfather previously authorized activities or transactions, no holding company should be exempt from affiliate abuse oversight.
- Third, Congress should ensure that the FERC and State regulatory authorities have adequate access to the books and records of *all* members of *all* public utility holding company systems when that information is relevant. This is necessary to prevent affiliate abuse and subsidization by electricity rate-payers of the nonregulated activities of holding companies and their affiliates.
- Fourth, if Congress transfers any PUHCA functions to the FERC, instead of repealing PUHCA in its entirety, Congress needs to provide the staff and administrative support necessary for us to carry out the additional responsibilities.

Mr. Chairman, since the hearing on this matter you held last year, your staff has worked cooperatively with staff of the FERC to fashion provisions that address the specific concerns we had with the legislation before the Committee last year. That effort was very productive, and resulted in suggested changes that are fully reflected in S. 621, the bill before the Committee today.

S. 621 would repeal the Public Utility Holding Company Act of 1935. In its place, it would enact the Public Utility Holding Company Act of 1997, which would do five major things:

- (1) provide the FERC with access to books and records of holding companies and their subsidiaries, and of any affiliates of holding companies or their subsidiaries (section 5);

- (2) give State commissions that have jurisdiction over a public utility company in a holding company system access to books and records of a holding company, its associates, or affiliates (section 6);
- (3) require the FERC to promulgate a final rule, no later than 90 days after the enactment, to exempt from the books and records access requirements of section 5 any person that is a holding company solely with respect to one or more: qualifying facilities under the Public Utility Regulatory Policies Act of 1978; exempt wholesale generators; or foreign utility companies (section 7);
- (4) provide that nothing in the Act precludes the FERC or a State commission from exercising its jurisdiction under otherwise applicable law to determine whether a public utility may recover in rates any costs of an activity performed by an associate company, or any costs of goods or services acquired from an associate company (section 8); and
- (5) grandfather activities in which a person is legally engaged or authorized to engage on the effective date of the new Act (section 12).

We believe that the provisions of S. 621 providing the FERC access to books and records (section 5) are sufficient to ensure that we can do our job as rate regulators. We appreciate your efforts to modify last year's bill to ensure that these provisions apply to all public utility holding companies. These modifications are central to our conclusion that rate-payers can continue to be protected if PUHCA is repealed.

We also believe that the grandfather provision (section 12) and the savings clause (section 8) have been properly clarified to address our previous concerns. We also have no objection to the requirement under section 7 that we exempt certain holding companies from the books and records requirement. We defer to the State commissions on the adequacy of provisions assuring them access to books and records of holding companies and their affiliates.

On this basis, we believe that if Congress follows the SEC recommendations to repeal PUHCA, S. 621 is an appropriate vehicle for doing so without impairing rate-payer protection. I thank you for your attention this morning and again for the efforts of you and your staff to accommodate our concerns.

I would be happy to answer any questions you may have.

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
TESTIMONY OF THE HONORABLE ROBERT W. GEE
COMMISSIONER, PUBLIC UTILITY COMMISSION OF TEXAS

ON

S. 621, THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1997

APRIL 29, 1997



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Introduction

Mr. Chairman and Members of the Committee, good morning. My name is Robert Gee. I am a Commissioner at the Public Utility Commission of Texas and Chairman of the Electricity Committee of the National Association of Regulatory Utility Commissioners, commonly known as NARUC.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental bodies of the 50 States engaged in the economic and safety regulation of carriers and utilities. The mission of the NARUC is to serve the public interest by seeking to improve the quality and effectiveness of public regulation in America. More specifically, the NARUC consists of the State officials charged with regulating the retail rates and services of electric utilities. We have the obligation under State law to assure the establishment and maintenance of such energy utility services as may be required by the public convenience and necessity, and to ensure that such services are provided at rates and conditions which are just, reasonable, and nondiscriminatory for all consumers.

Thank you, Mr. Chairman, for allowing me to appear at this hearing on an issue of critical importance to State utility regulators. Regardless of the fate of the Public Utility Holding Company Act of 1935 (PUHCA), the NARUC and State commissions will play an indispensable role in managing any transition to a more competitive energy market—an activity which is underway in 49 of the 50 States.

We also commend the Committee for its continued investigation as to whether the current statute is consistent with the changes in today's electric services industry. The changes affecting the electric utility industry, including State initiatives to promote competition and regulatory reform in retail power markets and the Federal Energy Regulatory Commission's (FERC) implementation of its rulemaking to open wholesale transmission access, makes this a timely opportunity to again consider whether the 1935 Act should remain the sole means of regulating registered utility holding companies.

Against this background, allow me to explain the NARUC's position on PUHCA. I will then proceed with a summation of the NARUC analysis of S. 621, introduced just days ago by the Chairman.

The NARUC's policy position regarding changes to the Holding Company Act was originally adopted in March 1995. A more recent resolution concerning PUHCA was adopted in July 1996. The recommendations made by the Securities and Exchange Commission (SEC) in June 1995, which recommended the "conditional repeal" of the Holding Company Act, recognize the importance of States' oversight of these types of utility systems. While the SEC's legislative recommendations are consistent with many suggestions made by the NARUC, the scope of the SEC recommendations are not. The NARUC favors changes to PUHCA only if made in conjunction with more comprehensive revisions to the Federal Power Act that enhance State restructuring activities.

We recognize that the Chairman's legislation, S. 621, largely comports with many of the SEC's policy recommendations, and the NARUC appreciates your efforts to affirm the importance of State oversight of multi-state utility holding companies. The Association also believes S. 621 moves in a positive direction toward rationalizing regulatory oversight in an increasingly competitive market. But a competitive market needs to function fairly and effectively before repealing the 1935 Act so that no market participant is provided an unfair competitive advantage by virtue of its corporate structure.

State Regulatory Authority

As stated in the NARUC's resolution adopted last summer, a principal concern with regard to reform of PUHCA is to "... ensure that the authority of the States to regulate utility holding companies is not pre-empted or restricted. ..." Transferring the SEC's regulatory authorities to the FERC may, indeed, provide for a more reasonable, streamlined approach to regulating the activities of these companies to ensure the provision of reliable service at reasonable costs. However, the NARUC also strongly believes that States have a compelling interest in ensuring that consumers are provided services at costs that are reasonable and justifiable. Therefore, any legislation to reform PUHCA must be balanced and continue to enable States to determine the reasonableness of utility costs of service so that consumers are not left paying rates that include costs of multi-state utility activities unrelated to the provision of energy services.

Transition

The NARUC believes that any transition period, whether contained in stand-alone PUHCA legislation or in a more comprehensive measure, should reflect the States' local market and the States' needs in obtaining the requisite enabling authorities

from their respective State legislatures prior to the effective date of the PUHCA repeal or reform. If stand-alone PUHCA reform legislation were to be passed, despite our serious reservations, we believe that a minimum 2-year transition would be advisable since not all State legislatures meet annually. If incorporated in a broader effort to amend laws governing the electric utility industry, we suggest that any PUHCA reformation be coordinated in a manner consistent with legislation that addresses customer choice and any provisions that address concerns relating to undue market power.

Inter-affiliate Transactions and Diversifications

The NARUC favors an approach to PUHCA reform that ensures the authority of the States to review prospectively requests for diversification, if a State so chooses, and to require that holding companies place non-utility businesses in separate subsidiaries, to regulate all inter-affiliate transactions, and to require divestiture of utility businesses. If States determine such actions are necessary to determine the reasonableness of costs for services provided to consumers, such determinations should be protected.

In addition, the NARUC cannot support a simple transfer of the SEC's authorities over affiliate transactions to the FERC without clarifying the FERC's and States' respective authorities over such transactions. Legislation to reform PUHCA must recognize and address the fact that holding company corporate structures are complex and can impose costs on utility rate-payers, and have proven to cause jurisdictional disputes among State and Federal regulators.

As you may know, a 1992 decision of the U.S. Court of Appeals for the D.C. Circuit, commonly referred to as the *Ohio Power* decision, held that SEC approval of non-power affiliate transactions prevails over any decision to the contrary made by the FERC or, by implication, the States. This decision threatens State regulation concerning the costs of inter-affiliate transactions sought by the utility to be recovered in retail rates and, accordingly, should be legislatively reversed to ensure that the costs of all non-power transactions between holding company affiliates be subject to review by the appropriate State and Federal rate-making authority. In short, the legislation must clarify States' unrestricted authority over affiliate transactions. Relaxing restrictions on utility diversification should not be allowed absent provisions which clearly define the States' authority to provide necessary safeguards.

Access to Books and Records

The NARUC's policy on PUHCA requires that any legislation to reform the Holding Company Act should unequivocally establish an enforceable State right of access by States to all such books and records, wherever located, that directly or indirectly affect consumers. States' rights to secure access to books and records is critical for the effective oversight of out-of-state activities of multi-state holding companies that affect utility rates.

Audits

Protecting the FERC's and States' ability to audit and investigate companies in a registered system is an important complement to the right to obtain access to books and records. The NARUC has been a longstanding proponent of independent authority for State commissions to audit transactions between the parent holding companies and their subsidiaries and affiliates. The NARUC also supports State efforts, working in conjunction with Federal regulatory authorities, to audit multi-state registered holding companies in a coordinated fashion.

Consideration of Mergers and Market Power

Since the adoption of the NARUC's 1995 resolution on PUHCA, and while the Congress has debated the necessity of PUHCA, electric utilities have begun bracing for the onset of a more competitive energy sector. As a means to strengthen their position in any newly structured electric market, utilities have engaged in mergers, or have contemplated mergers, with potential competitors. Industry consolidation has been argued by some to be inconsistent with the efforts being taken by both the FERC and the individual State commissions and legislatures to enhance the choices wholesale and retail consumers are to be provided on an unbundled basis.

The NARUC expressed its concern in a 1995 resolution that economic efficiencies associated with growing competition may not be realized if mergers have an adverse impact of competition in the generation market. The Association reiterated its concerns in its July 1996 resolution by stating that "[a]ny legislation must recognize that regulation should be reduced only as competition becomes effective at preventing monopoly abuses and allowing pro-competitive change and availability of customer choice." As we continue to debate the role of PUHCA in the current electric market, and as a more market-oriented approach to the provision of energy services

is contemplated or implemented, we must also be mindful of the potential for market power being concentrated in the hands of fewer competitors. For this reason, the NARUC supports the establishment of a mechanism that maintains effective State and Federal regulation against abusive holding company practices that could place undue market power in the hands of multi-state holding companies and harm the development of competition.

**Suggested Improvements to S. 621—
The Public Utility Holding Company Act of 1997**

While the NARUC believes that PUHCA reform legislation should not pass separately from the legislation to more broadly amend Federal electric utility laws, the Association would be remiss not to suggest ways to further improve S. 621 should it ultimately proceed to a Committee vote. First, though, the Association would like to commend the Chairman's recognition of the need for States to protect customers of multi-state electric utility holding companies from potential abuses. The bill helps to ensure the States' ability to access multi-state holding company books and records, audit multi-state holding companies, and regulate affiliate transactions within a holding company system.

Also, the provisions pertaining to State access to books and records will go a long way to enable States to meet their State-mandated oversight responsibilities. The NARUC commends the Chairman for including, in this year's bill, provisions added to last year's bill by the Committee that address the enforcement of books and records accessibility, which are identical to the approaches contained in the Energy Policy Act of 1992 and the Telecommunications Act of 1996. Because those changes to the Act would be repealed if S. 621 were enacted in its current form, such an enforcement provision should be clarified to ensure the continued right of State commissions to obtain access to books and records of exempt wholesale generators and exempt telecommunications companies.

Prior to the adoption of S. 621 by this Committee, the NARUC also requests clarification of the exemption provisions. It would be helpful if the authority given to the FERC to terminate a grandfathered utility exemption under the 1935 Act was revised to ensure that all of the utility holding companies are subject to comparable regulatory treatment regardless of corporate form. Also, the NARUC would support clarifying that the FERC's authority to exempt "any person or transaction" does not translate into an ability to exempt utility companies from State regulation under this legislation, including the ability to obtain access to books and records.

As stated above, the NARUC advises the Committee to include a more meaningful transition period to enable States to obtain the requisite authorities to effectively oversee multi-state holding companies if this bill were to be enacted into law. While we appreciate the Committee's response to our concerns during last year's debate by changing the effective date from 12 to 18 months, in our view, a transition period of 2 years, at a minimum, would be more appropriate to enable State commissions to acquire such enabling authorities necessary for meaningful oversight of registered holding companies.

For instance, in my State of Texas, as well as other States, the State legislature meets just once every 2 years. In fact, the Texas legislature is meeting this year. When the Texas legislature meets, it traditionally does so for just 6 months at the beginning of the year. Therefore, if PUHCA repeal were enacted into law this year, my public utility commission would need to assess whether it required additional multi-state utility oversight authority and, if so, would need an opportunity to seek such authority from our legislature. However, because our commission would not be able to secure such authority until 1999, during such time we could be without adequate safeguards to protect consumers from cross-subsidization abuses and diversification risks. Further, in other jurisdictions, registered holding companies would be free to restructure or to diversify into other lines of businesses conceivably absent any State or Federal oversight.

Again, incorporating these suggestions are important whether PUHCA reform legislation proceeds on a stand-alone basis or as part of a comprehensive measure with the understanding that the NARUC recommends against pursuing PUHCA reform legislation separately.

Conclusion

As we continue to advance toward a more competitive electric market, PUHCA may indeed become less relevant. However, in the absence of a truly competitive market, we must still carefully assess what safeguards are necessary to protect consumers from potential abusive practices by holding companies. We must also evaluate whether such changes are consistent with the pro-competitive changes in the electric market and do not discourage greater competition in the marketplace. For

these reasons, the NARUC believes that reform of PUHCA must be considered in conjunction with broader changes to the Federal Power Act that support State and FERC efforts to provide utility customers with options in the emerging competitive markets.

The NARUC, again, appreciates the opportunity to present its views, and looks forward to working with the Chairman and Members of this Committee in crafting legislation that complements State and FERC efforts to promote competition in the utility industry while assuring that the utility rate-payers are provided adequate protections against possible abuses.

Resolution on Legislation to Change The Public Utility Holding Company Act of 1935

WHEREAS, legislation to reform or repeal the Public Utility Holding Company Act of 1935 (PUHCA or the Act) is again being considered by Congress, in light of an increasingly competitive electricity market and the potential economic efficiencies associated with growing competition in the electric industry; and

WHEREAS, the National Association of Regulatory Utility Commissioners (NARUC) and State commissions will play an indispensable role in managing any transition to a more competitive energy market in order to ensure that energy services are provided at rates and conditions that are just, reasonable, and nondiscriminatory for all consumers; and

WHEREAS, the NARUC supports reducing some of the restrictions and prohibitions of the Act, while favoring those specific enforcement mechanisms in the PUHCA amendments enacted in the Energy Policy Act of 1992 and the Telecommunications Act of 1996 which, inter alia, provide State commission access to holding company books and records of exempt wholesale generators and exempt telecommunications companies, State consent for sale of jurisdictional utility assets, protection against abusive affiliate transactions, and independent audit authority for the effective discharge of State oversight responsibilities; and

WHEREAS, the NARUC, by a previous resolution on PUHCA reform, supports the position that such reform should not include arbitrary distinctions based on corporate structure, should ensure that the authority of the States to regulate utility holding companies is not pre-empted or restricted, and should include a meaningful transition period before the new Federal legislation takes effect;

NOW, THEREFORE, BE IT RESOLVED, by the Executive Committee of the National Association of Regulatory Utility Commissioners, convened at its 1996 Summer Meeting in Los Angeles, California, that any legislation to change PUHCA should be consistent with the following:

1. Reform or repeal of the Public Utility Holding Company Act of 1935, and the amendments set forth by the Energy Policy Act of 1992 and the Telecommunications Act of 1996, should be considered in light of discussions on comprehensive legislation to revise the Federal Power Act and restructure the electric utility industry through appropriate State processes.

2. A sensible mechanism should be established that maintains effective State and Federal regulation against abusive holding company practices which could place undue market power in the hands of multi-state holding companies and harm the development of competition. Any legislation must recognize that regulation should be reduced only as competition becomes effective at preventing monopoly abuses and allowing pro-competitive change and availability of customer choice.

3. Any comprehensive legislation should be consistent with the PUHCA reform provisions embodied in the Energy Policy Act of 1992 and the Telecommunications Act of 1996 as supported by the NARUC and provide for (a) State consent for the sale, encumbrance, or disposition of existing State jurisdictional rate-based facilities, (b) reporting obligations concerning investments and activities of multi-state public utility holding company systems, (c) restrictions against assumption of liabilities of non-regulated activities through securities issuances, guarantees, endorsements, or sureties and the pledging or mortgaging of assets, (d) protection against abusive affiliate transactions, (e) prohibitions against reciprocal arrangements entered into in order to avoid the provisions of that legislation, (f) Federal and State commission access to books and records, (g) independent audit authority for State commissions, and (h) nonpre-emption of State rate authority; and finally, nothing in that legislation should affect the authority of State commissions under State laws concerning the provisions of utility services, to regulate the activities of a public utility which is an affiliate, subsidiary, or associate of a multi-state public utility holding company, and other relevant consumer protections.

4. Any comprehensive legislation should provide the States with the flexibility to respond to changes in the utility industry arising from market forces, technology, or financial conditions.

With these protections in place for consumers, the States will be able to regulate where they must to protect the public interest and deregulate when market conditions warrant.

Sponsored by the Committee on Electricity

Adopted July 25, 1996

Reported NARUC Bulletin No. 32-1996, page 13

PREPARED STATEMENT OF RONALD J. TANSKI

VICE PRESIDENT AND CONTROLLER

NATIONAL FUEL GAS DISTRIBUTION CORPORATION, BUFFALO, NEW YORK

APRIL 29, 1997

Good morning, Mr. Chairman and Members of the Committee. My name is Ronald Tanski. I am Vice President and Controller of National Fuel Gas Distribution Corporation, the public utility subsidiary of National Fuel Gas Company. National Fuel is one of only three registered natural gas holding companies and the only registered company in New York State. I am here to emphasize our continuing support for reform of the Public Utility Holding Company Act, subject to the need for uniform inter-state treatment of holding company systems.

At the hearing before this Committee last June on the predecessor to S. 621, we were all involved in debating our views on the issue of PUHCA reform. Having heard the testimony of other parties, it is clear that National Fuel's initial perspective, that simple PUHCA repeal would minimize our regulatory burdens, was itself overly simple. I say this now because PUHCA repeal alone is clearly unacceptable to many other interested parties, especially consumer groups.

Consumer groups, among others, believe that in the event of outright PUHCA repeal, market power issues will require additional FERC and State review authority over holding company financial transactions and investments. With due regard to those concerns, a company like National Fuel, which has businesses regulated by the FERC and two State public utility commissions, has its own concerns about additional regulatory burdens on three fronts. In particular, we strongly believe that granting powers of review over holding company activities to 50 State agencies and the FERC will, without doubt, result in increased, uncoordinated burdens on all of the companies in the holding company system. With the repeal of PUHCA and the proposed extension of authority to 51 agencies, no one entity will be charged with the duty of adopting a balanced approach that gives weight to all interests and implements appropriate protections.

For these reasons, while still actively supporting reform in the public utility holding company arena, National Fuel believes that PUHCA reform must include some narrow retention of SEC authority over financial matters and a continued SEC role in the auditing of such matters.

I also want to emphasize my company's continued position that repeal of the restrictions on investment in our now almost completely deregulated gas industry should happen immediately. National Fuel is part of an industry which has been through a difficult, wrenching restructuring and is now operating in a robustly competitive environment. The 1935 Act imposes burdensome regulation which hinders that competition.

Those who advocate waiting for electric industry restructuring ignore the fact that the natural gas industry has already restructured, yet it still remains subject to requirements that limit its flexibility to respond to the constantly changing market conditions.

When PUHCA was enacted 62 years ago, our industry was a vertically integrated utility system which would produce natural gas, transport that gas by pipeline, and distribute it to all retail customers in a geographically restricted service territory.

Today's natural gas industry no longer bears any significant relationship to the natural gas industry of 1935. Wellhead prices have been decontrolled and prices are set by the market.

Pipeline rates remain regulated by the FERC, but rates and services have been unbundled. Customers can purchase transportation, storage, and other services separately and the pipeline no longer bundles the services for a single inclusive rate.

Brokers, hub operators, and marketers compete against us in providing mixes of services for our customers. These nonregulated companies provide at market prices the bundling that regulated pipelines once performed.

Local distribution to retail customers remains subject to State commission requirements, but in many States these same customers have the opportunity to purchase gas at the wellhead and arrange their own pipeline transportation of that gas.

Last year, our utility and the other major utilities in New York filed new tariffs designed to unbundle our retail services to all of our customers. Residential customers are now able to choose their natural gas supplier in that State. Residential customer choice will soon be available in our Pennsylvania utility operation through our recently filed "Energy Select" pilot program. Most of the suppliers competing, or soon to be competing, with us are completely unregulated. As I drive in to work in the morning, I can hear advertising on my car radio urging listeners to buy their energy from an unregulated company located over 1,400 miles away. In the meantime, National Fuel must deal with significant regulations at both the State and Federal levels.

We are committed to allowing all of our customers to choose where to buy their gas and we will provide the transportation of those volumes. But in order to be able to compete against unregulated marketers who can change their prices on a moment's notice, we must reduce the burden of regulation.

We must be careful, however, not to replace the 1935 Act with more burdensome and extensive regulation. As currently drafted, S. 621 grants oversight authority to at least 51 different agencies. Given that State agencies, in particular, have a very narrowly defined geographic interest, they cannot be considered the best entities to oversee the implementation of a consistent inter-state consumer and investor protection policy. Hence, to the extent regulatory oversight of the financial transactions of holding company systems should continue, it should rest with the SEC, a well-respected body with significant expertise and experience in the area.

Thank you, again, Mr. Chairman, for the opportunity to testify before your Committee today. I would be pleased to answer any questions you may have.

PREPARED STATEMENT OF FERD C. (BUZZY) MEYER, JR.

SENIOR VICE PRESIDENT AND GENERAL COUNSEL
CENTRAL AND SOUTH WEST CORPORATION, DALLAS, TEXAS

APRIL 29, 1997

Good morning, Chairman D'Amato and Members of the Committee. My name is Buzzy Meyer. I am Senior Vice President and General Counsel of Central and South West Corporation (CSW) and its subsidiaries. CSW is a registered electric holding company under the Public Utility Holding Company Act of 1935, headquartered in Dallas, Texas, and I am here today on behalf of the Repeal PUHCA Now! Coalition.¹ I appreciate the opportunity to appear at this hearing, and I wish to acknowledge the leadership demonstrated by both the Chairman and Ranking Member of this Committee in having introduced legislation repealing the Public Utility Holding Company Act of 1935 and for scheduling this hearing on S. 621, the Public Utility Holding Company Act of 1997.

Since its incorporation in 1926, the goal of CSW has been to ensure that the customers of CSW's utility subsidiaries received reliable and economical electric power and that its shareholders received a fair return on their investment in this capital-intensive company. As long as the demand for electricity and energy services grew at rates of 10 percent or more, these goals were relatively easy to meet. However, since we have become "a mature industry" and growth is less than 2 percent, we are forced to seek flexibility to respond to growing competitive pressures. This company, perhaps more than others, has experienced much frustration under the Act. We have had the "unique" honor of having the longest outstanding application on record, some 7 years, only to have the SEC admit that even while they agreed with

¹The Repeal PUHCA Now! Coalition includes the following: Allegheny Power System, Inc., American Electric Power Company, Inc., American Gas Association, Central and South West Corporation, Central Illinois Public Service, Cinergy Corp., Columbia Gas System, Commonwealth Edison Co., Consumers Power Company, Eastern Utilities Associates, Edison Electric Institute, Entergy, General Public Utilities Corporation, Interstate Natural Gas Association, Kansas City Power & Light Company, Missouri Companies, National Fuel Gas Company, New England Electric System, Northeast Utilities, Northern States Power Company, Pacific Gas & Electric Company, PacifiCorp, Southern California Gas, Public Service Company of Colorado, The Southern Company, Union Electric Company, Unitil Corp., and Western Resources Inc.

the merits of our request, they were powerless to approve it unless the Act were changed. (*CSW Credit, Inc., et al.*, HCAR No. 25995 (March 2, 1994).)

Mr. Chairman, as you are aware, we have been seeking relief under the Act for now many years. We have witnessed your leadership in the early 1980's when the SEC under the Reagan Administration recommended repeal of PUHCA to Congress, and we have witnessed the SEC under the Clinton Administration, after a year-long study, recommend repeal of PUHCA to Congress. During that time, our company has tried to position itself to bring the greatest value to our customers and shareholders. During that time, I have had the privilege of serving on many industry committees, and of meeting regularly with regulators, investors, and rate-payers. Certainly all who understand the Act agree that PUHCA should have been repealed some time ago. Certainly, the time to repeal PUHCA is now and I urge this Committee to report S. 621 favorably, as soon as it can reasonably be done.

My company and the other members of the Coalition, the SEC commissioners and staff, the leading trade associations in both the gas and electric utility industries, and many other analysts and commentators, all agree in concluding that PUHCA has long outlived its usefulness. It has become a regulatory anachronism, a barrier to competition and to innovation. Change is occurring rapidly in our industry, and PUHCA imposes unneeded restrictions, significant costs, and confers no real benefit.

PUHCA should be repealed now. Its repeal should not be contingent on other policy and legislative issues that may affect the gas and electric industries. Simply put, PUHCA repeal should not be held hostage to the important debates about restructuring in the electric industry, or retail wheeling, or the future of the Public Utility Regulatory Policies Act of 1978 (PURPA). These are important issues that impact all stakeholders in the electric utility industry. They deserve serious study, discussion, and debate and we hope Congress will give them the attention they deserve—but do it separately from consideration of S. 621.

Serious debate and discussion of these other issues is still ongoing and there are many different views to reconcile. Conversely, a full merits review of PUHCA repeal started more than 15 years ago, and there is near unanimity that the 1935 Act is no longer required to protect customers or consumers. Indeed, in 1982, the SEC found that PUHCA's statutory objective had been achieved. In the intervening 15 years, the case has been overwhelmingly built to show that conclusion was correct. Two years ago, after conducting a full study of the issues, including significant public participation, the SEC again concluded that PUHCA was no longer needed and that, with appropriate conditions to assure the availability of regulation authority over utilities, repeal was the preferred option.

We agree that the supporting analysis is clear and irrefutable. We congratulate the SEC for accomplishing the goals set out for it at the time of the passage of the Act in 1935, and agree that continuing that authority burdens the industry and the agency, and does so at a cost which far exceeds any alleged benefits.

I. The Coalition and Its Members

As I noted, I am appearing today not simply on behalf of my own company, and, indeed, not simply on behalf of the registered gas or electric holding companies, but on behalf of a Coalition that seeks repeal of PUHCA. Repeal of the 1935 Act is important not just to those companies that for 60 years have borne the burden of its regulatory requirements, and whose ability to respond to the existing competition is handicapped by that Act, but to other utilities—gas and electric as well as to other potential participants in industries going through dramatic changes.

I think it is impressive that our Coalition includes virtually all of the current registered companies. On this issue, gas and electric registered holding companies are united: We all need the ability to respond more freely and flexibly than we can under the Act to market opportunities and to the needs of our customers.

Similarly, companies now exempt from the Act's requirements—again, both gas and electric—also seek repeal. The potential application to them of the Act's full strictures, and the current imposition of limits on their ability to serve customers geographically or through additional utility services, hinders innovation and frustrates the further development of competitive markets.

My friends in the gas industry have already experienced significant, some would say overwhelming, change. They now face competition in every facet of their business, yet they remain subject to additional regulation over their lines of business, corporate structure, and financing that their competitors do not have. PUHCA's regulations impose higher costs and less flexibility, handicapping them in meeting the demands of their competitive markets. I know others testifying today will speak more about those issues.

Repeal of PUHCA, with appropriate safeguards to remain in place, is essential now, to let competitive and innovative developments occur, even while the regu-

latory agencies and the legislatures, including Congress, further consider changes in energy policy as applied to the electric and gas industries.

II. The Burdens of PUHCA

Those of us who operate as registered companies know how burdensome and limiting the requirements of PUHCA are, and the disadvantage at which we are placed compared to other industry participants:

- We are limited to serving utility customers in a "single integrated" service territory. As a result, we cannot (except in limited circumstances) expand to offer services to others, even in our core business, either by expanding our operations or investing in other utilities, as can be done by non-holding company utilities.
- We need *prior* approval from the SEC before our affiliates and subsidiaries can enter into contracts with each other. The SEC determination on the terms (including whether the contract will be at market rates or at cost) is binding on rate regulatory agencies. As a result, opportunities to save some costs or to operate with efficiencies, available on short notice, cannot always be seized.
- We and our non-utility subsidiaries are not able to issue or sell securities, or alter security rights and powers, without prior SEC approval. As a result, our capital structures are much more limited; and our ability to take advantage of financing opportunities, especially in dynamic capital markets, is more limited; and we cannot use several types of securities which are now widely accepted as appropriate in our industries.
- Without a special SEC approval, we cannot invest in any other lines of business—under existing SEC interpretations, we are limited to the single utility business, plus only such other businesses as are "functionally related" to the operation of a utility business. Businesses that make good financial and economic sense, business opportunities that would help additional economic development in our service territories, and even businesses that if allowed to operate freely would save our customers money, may be foreclosed. The SEC's recent efforts to provide some administrative relief, such as through Rule 58, have highlighted this point. Rule 58 does *not* free the registered companies from restriction. Rule 58 merely codifies the SEC's precedents of what lines of business are "functionally related," and the SEC's previous case-by-case decision to allow companies to operate in these businesses. To offer services that our customers want and need, registered companies must have greater flexibility than Rule 58 provides.

Even the exempt companies, although free of virtually all of the specific restrictions in PUHCA, are limited to serving utility customers in a specific geographic area, lest they lose their exemption. They also must consistently worry about diversification, because the SEC has the power to revoke their exemption under the "unless and except" clause.

Although they were important at the time of passage, the stringency and severity of these restrictions make little sense in today's circumstances. In the 62 years since 1935, securities markets have become much more effective and efficient. The SEC's other authorities under the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Advisors Act of 1940, and the Investment Company Act of 1940 assure that investors receive appropriate information, and can make informed decisions. Rating agencies, such as Moody's and Standard & Poor's, constantly evaluate our management and operations and rate us accordingly, and believe me, as an interest sensitive industry, we are vigilant in maintaining or improving our ratings by these agencies. Moreover, there is extensive financial and corporate information available commercially through hundreds of magazines, newsletters, on-line computer services, and network sources, enabling the markets to respond within hours of significant events.

Similarly, the utility regulatory commissions, both the FERC and the State commissions, have clearer authority than was in place in 1935. The standardization of utility accounting, better staffing, and more clearly defined requirements have all made rate regulation more effective. Changes fostered by other congressional actions, including some provisions of PURPA, the Natural Gas Policy Act (NGPA), and the Energy Policy Act of 1992; by the FERC, including Orders 436, 500, and 636, on the gas side; and the new rules in the FERC Orders 888 and 889, 888A and 889A regarding transmission access on the electric side; and by the State commissions, including Texas and California as well as many others, are establishing competitive markets, instead of regulation, as the mechanism to enforce efficiency and cost effectiveness in the utility business.

In light of the change the electric industry is experiencing now, and expressly in light of the authority that already exists in the SEC, the FERC, and the State commissions regarding the securities markets and rate matters, PUHCA has become a

redundant anachronism. It lacks the flexibility to allow the companies to adapt to new circumstances. Its model of the utility industry simply no longer comports with what the industry is doing, and what the FERC and the State commissions would like us to do. We need *permanent* and complete relief today from the unnecessary regulatory burdens imposed by the Act, and the proper relief is repeal, as set out in S. 621.

III. The SEC Report and Recommendations

The SEC reached that same conclusion—that the Act, as implemented by the SEC since 1935, has achieved its purposes, and now is not required for effective regulation. Indeed, the Act must be repealed to level the playing field in the new circumstances of the industry. The costs and burdens imposed by the Act, on the SEC and its staff as well as on us, do not provide sufficient real benefit.

Certainly there had been abuses at the time PUHCA was passed in 1935. The SEC's report carefully describes the implementation efforts that were made by the commission, and the success of those efforts. The pyramided holding structures are long gone, and (as the SEC says) are not likely to reappear. The leveraged financial structures and the resulting risks to investors are gone, and (as the SEC says) are not likely to reappear. The limits on State and Federal regulatory authority have been corrected.

Based on its own detailed review, the SEC recommends repeal of the Act. The SEC emphasized that halfway measures, such as putative "reform" of the Act to provide for additional exemptions or to streamline certain aspects, will not achieve the benefits of repeal. We agree with the SEC's conclusion in that regard. There are significant benefits to be achieved, by the regulated companies, by the regulators, by consumers, and by investors. But those benefits will not be achieved unless Congress repeals PUHCA.

It is true that the SEC's preferred option is repeal with limited conditions, and I will address those conditions in a moment. Some will want to stress that the conditions are essential if repeal is to occur. The stronger point is that repeal is essential to obtain the benefits identified, and that any conditions must not be so limiting as to destroy the benefits to be achieved.

The SEC also has undertaken some administrative reforms, to be put in place while legislative consideration goes forward. Those administrative reforms are helpful in making changes that ease some of the burdens, and the registered companies appreciate the SEC's efforts. However, I must be blunt. Those administrative reforms are at best halfway measures—because the commission's authority to make essential, fundamental change, is limited. Some have challenged even those limited administrative reforms. The administrative reforms, while useful and important, are not by themselves enough to correct the essential problems with the Act. S. 621 addresses those essential problems, and only repeal, with safeguards, will achieve the benefits that are available.

IV. Conditions on Repeal

The SEC's report suggested that certain consumer concerns be addressed along with repeal, and the bill you introduced, Mr. Chairman, addresses all these issues. Specifically, the SEC has proposed that any repeal of the Act also include provisions (1) to ensure access to books and records which are required for the effective discharge of a State's regulatory responsibilities; (2) to establish Federal audit authority; and (3) to establish some locus for Federal oversight of intrasystem transactions. The SEC also suggested that the task of carrying out those new provisions be given to the FERC.

State commissioners and some rate-payer advocates have expressed concern that State authority would not be sufficient to obtain necessary information for proper discharge of State regulatory action; and that there would be a continuing need, after repeal of PUHCA, for Federal audit authority and Federal oversight of system transactions that would pass costs through to rate-payers. We understand those concerns, and we also understand the significant difference between repealing the Act while providing for certain safeguards, and simply transferring the existing burdensome requirements to a new forum. We believe S. 621 fully addresses these concerns and includes provisions to provide access to books and records, and to grant audit authority to the FERC. Those provisions reflect input from the SEC, the FERC, and the State commissions last year. While there may be fine-tuning of these provisions, we are fully prepared to work with you, the Members of this Committee, and Congress to assure that the final bill includes provisions that would implement any necessary safeguards. Of course, any such provisions should recognize the authority which already exists, and which already addresses these important issues.

With regard to books and records, all utility companies, including ours, know full well that the books and records of the utility company must be available to regulators for their review, and that the burden will remain on a utility to demonstrate that its proposed rates are just and reasonable under the circumstances. Similarly, we understand and can accept a review of the books and records of those affiliates that deal with the utility company and that would thereby pass costs through in rates. However, there are undoubtedly some affiliates in a diversified company that will not pass costs through to rate-payers, or whose activities are so removed from the utility activities, that access to their books and records would be of no legitimate value for rate-making or cost allocation purposes. The key test is what access is necessary for the effective and proper discharge of the regulatory authority involved. We look forward to continuing to work with your staff on this point.

Similarly, we understand the need for audit authority as it relates to an operating utility, and those that are providing services to it, and whose costs will be passed through to rate-payers. Again, the proper test ought to be the regulatory need for or the regulatory benefit to be achieved by an audit in light of regulatory jurisdiction and the likelihood of costs being passed through to rate-payers. Here, too, we look forward to working with staff and the commissions.

In regard to the oversight of affiliate transactions, again we understand the interest of regulators in reviewing those transactions involving the utility, and which will cause the incurrence of costs to be passed through to rate-payers. Indeed, many State regulatory commissions already review transactions between a utility and its affiliates, and no further authority is needed. However, we can also envision a number of transactions between affiliates completely apart from the operating utility companies, which would not cause the incurrence of costs to the utility. Where the affiliate contractual arrangements are not related to costs to be incurred or passed through in the utility's regulated rates, or where those arrangements are market transactions, separate regulatory review of the inter-affiliate transactions would be unnecessary. We will be pleased to work with your staff in developing language to resolve these issues in an appropriate way.

Over the years that CSW and others have advocated repeal of PUHCA, we have heard many arguments for delay or for continuation of PUHCA's unnecessary restrictions. Let me address these arguments in turn.

Concentration of Market Power

Some have asserted it is essential to retain PUHCA in order to limit what they call "concentrations of market power" as the electric industry restructures. Those who make that assertion either do not understand the role PUHCA has played, or willfully misstate it. PUHCA's existing provisions actually *increase* the likelihood of concentrations in particular markets, because the "integration requirements" and geographic restrictions of the Act limit both registered companies and exempt companies to retail utility holdings in particular areas, and restrict the ability of more distant companies to acquire, construct, or operate facilities that could compete with the local utility. PUHCA effectively keeps new entrants out of the markets, and also keeps registered companies from engaging in competitive lines of business. Indeed, PUHCA as it stands, requires utilities to limit acquisitions to nearby utilities—ones that can be integrated or that do not result in a loss of exempt status. Those nearby utilities are the ones most likely to have presented the possibility of competition.

Repeal of PUHCA will not create circumstances where additional mergers will foster increased concentrations of market power. As the SEC itself stated in its report 2 years ago, its policy toward mergers and acquisitions in the utility industry has been one of "watchful deference"—deference to the determinations of the FERC and State commissions regarding the efficiencies or other benefits to be gained, and the conditions to be imposed on any proposed utility merger possibly subject to the Act.

It is important to recognize several facts about mergers and market power assertions if PUHCA is repealed. First, the very same expert agencies who *today* substantively review mergers will do so after the 1935 Act is repealed. The FERC will retain all of its merger authority, it will pursue consideration of its merger policy, and, indeed, it will have the assurance that future mergers will not create new *Ohio Power* or other similar regulatory conflicts at the Federal level. State commissions will still have their authority to approve, block, or condition mergers that they have today under State law. PUHCA's repeal will have no effect on that. The Department of Justice will retain its antitrust authority under the Sherman Anti-Trust Act, and the Federal Trade Commission and the Department of Justice will retain their Hart-Scott-Rodino authority. *The only thing that will change when PUHCA is repealed is that after all of those approvals are given, the SEC will no longer have the unnecessary and duplicative regulatory burden of again stating its deference to the decisions the other regulatory agencies have already reached.*

As the number of mergers proposed, announced, or accomplished within the last 2 years shows, the FERC and the States have ample authority and experience to address market power issues. The repeal of PUHCA will not affect the regulatory oversight of mergers.

Consumer Protections

Others assert that PUHCA is part of an essential group of consumer protections, and repeal cannot occur without those protections. Let me state the obvious: The ultimate consumer protection is the rate-making authority of the State commissions and the FERC. These bodies have the plenary authority to disallow any costs which may be borne by the rate-payer. Whether the concern is the cross-subsidization to a nonregulated subsidiary, losses from non-utility investments, or the increased cost of capital on an operating company due to bad management decisions by the holding company, not one penny of these costs can be passed along to the rate-payer without approval by either the State commissions or the FERC.

But PUHCA is not a utility rate regulation statute. Neither PUHCA nor the SEC have anything to do with retail or with wholesale rates. PUHCA is about restricting corporate structure and finance and was enacted to address a unique set of circumstances that, because of other laws, regulations, and marketplace realities, is incapable of reoccurring. Because the restrictions are so severe, the Act now stands like a Maginot line—a barrier built for the last war—facing the wrong direction for the challenges of the present and the future.

But, in any event, S. 621 fully addresses concerns about consumer protections. It assures FERC and State authority to review all of the relevant books and records. It assures that relevant regulatory agencies will be able to audit those matters that pass costs on to consumers. By repealing PUHCA, it assures that at the Federal level, there will not be inconsistent positions on affiliate costs and affiliate contracts. As FERC Chair Moler has repeatedly said, at least until the issues relating to competitive markets are resolved, the best consumer protection is effective and efficient utility rate regulation. PUHCA isn't about that, and in some ways PUHCA infringes on that. PUHCA's repeal through S. 621 will assure necessary rate regulation is available, while eliminating duplicative and costly burdens.

Just Wait for the Package

Lastly, there are those who do not argue that PUHCA is needed. Indeed, they agree that PUHCA is anachronistic, burdensome, and unnecessary. But they urge this Committee and Congress to wait—wait for electric industry restructuring; wait for some package that has yet to be introduced, much less considered.

For all of the reasons I have already given, PUHCA repeal can and should go forward without waiting for electric industry restructuring. Those issues will be dealt with, but they deserve our full and thoughtful consideration. The Energy Committee has held several workshops and has more scheduled. The FERC is carrying on that process at the wholesale level, and almost all the States have some consideration of that process underway, with several actively implementing competition programs. I have every confidence that the process will continue, and that we will be active participants in it. But PUHCA prevents some aspects of the proper experimentation that the States wish to undertake from going forward. PUHCA prevents not only my company but all companies from competing equally in the developing markets. PUHCA prevents my friends in the gas industry from competing, even though restructuring has already occurred in that industry.

We strongly urge this Committee to take the step which is within its jurisdiction, and favorably consider S. 621. Do not burden this significant step forward by including other matters. Let the process of experimentation, consideration, and development occur on the other issues, which will ripen to conclusion in their turn. This bill is ready, this issue is ripe, the case has been proven, over and over again.

V. Conclusion

SEC Chairman Arthur Levitt, at the commission meeting adopting the SEC's report, noted the extraordinary power granted by PUHCA—the authority to refashion the structure and business practices of an entire electric and gas industry. Commissioner Isaac Hunt has stated that PUHCA is the most restrictive Act enforced by the SEC and that the concerns PUHCA forces the commission to focus on are adequately addressed by the other Acts under its jurisdiction.

The SEC has implemented the reforms that Congress sought to achieve through PUHCA, and the abuses have been corrected. As the commission itself has found, the Act now imposes direct burdens on both the gas and electric industries and the SEC, and lacks the flexibility to respond to the current financial markets, as well as the changes taking place in the gas and electric sectors. The SEC's Director of Investment Management suggested that implementation of the recommendations—

repeal of the Act—would facilitate consumer protection, would encourage innovation and flexibility, and promote competition by acting to remove unnecessary regulation, thus enabling companies to provide energy to America's consumers in a flexible, efficient, and competitive manner.

We agree, and we hope that this Committee, and this Congress, will agree. We urge that you move quickly to consider and pass S. 621, and we look forward to working with you for its enactment.

Thank you, Mr. Chairman, for the opportunity to testify. I will be happy to respond to any questions.

PREPARED STATEMENT OF LES E. LoBAUGH, JR.

VICE PRESIDENT, GENERAL COUNSEL, AND CHIEF ENVIRONMENTAL OFFICER
PACIFIC ENTERPRISES, LOS ANGELES, CALIFORNIA

APRIL 29, 1997

Mr. Chairman, Members of the Committee, I am Les E. LoBaugh, Jr., Vice President, General Counsel, and Chief Environmental Officer of Pacific Enterprises (PE), which is an exempt holding company under the 1935 Act. I manage a law department of nearly 100 people who provide a broad range of legal services addressing issues of concern to PE and its subsidiaries. Since joining PE in 1975, I have served in a number of positions, including Associate General Counsel, Assistant General Counsel, and Senior Counsel. Prior to joining PE, I was an associate with Holberg, Finger, Brown & Abramson in San Francisco. I received my JD from Georgetown University's Law Center in 1970.

By way of background, PE is the parent company of Southern California Gas Company (SoCalGas), the Nation's largest natural gas distribution utility. SoCalGas serves more than 17 million people through 4.7 million meters.

Thank you for inviting me today to discuss the exempt utility holding company's perspective regarding conditional repeal of the Public Utility Holding Company Act of 1935 (PUHCA). Since the issue of utility diversification is often raised in the debate regarding PUHCA, in addition to addressing your concerns, I would also like to discuss the diversification experiences of Pacific Enterprises.

I should also note that PE is engaged in the process of obtaining approvals for a planned merger of equals with the Enova Corp., the parent company of San Diego Gas & Electric Company. This merger will add another 3 million people to our customer base and will result in savings to shareholders and rate-payers of \$1.2 billion over 10 years. The combined company would also be exempt under the 1935 Act.

Pacific Enterprises and Enova recently filed a response to protests to our merger application pending before the Federal Energy Regulatory Commission (FERC). The issues raised by parties that oppose our merger are all State regulatory issues that either have been or are being addressed by the California Public Utilities Commission. The opponents are the very same parties that fear the competition in energy services that PE and Enova represent, or fear the consequences of energy market competition itself.

As recently as just 10 years ago, the Securities and Exchange Commission (SEC) rules would not have permitted an exempt holding company such as PE to become a combination company, and our proposed merger with Enova would not have been approved by the SEC. I raise this issue both because it demonstrates how interpretations of law are subject to change, and also to suggest the negative impact that differing interpretations may have upon businesses seeking to operate within a competitive marketplace.

Since it is my understanding that your Committee is particularly interested in our thoughts regarding three issues, I will first address them before detailing PE's previous diversification efforts: Should PUHCA repeal be treated as a separate issue or as part of a package of reforms; what are the market power implications of conditional PUHCA repeal; and whether or not any additional consumer protections are required as part of PUHCA repeal.

Should Conditional PUHCA Repeal be a Stand-Alone Issue?

This question has been raised within the context of the ongoing debate regarding whether Congress should pursue comprehensive electric industry restructuring legislation. We commend the comments of Chairman D'Amato, and of Senate Energy Committee Chairman Murkowski, regarding the importance of keeping PUHCA separate from the broader debate over electric industry restructuring.

I urge the Committee to remember that PUHCA is not an electric industry issue, but as the SEC has so aptly noted, it is a securities issue involving both the electric

and gas industries. We, for example, are here because SoCalGas is a natural gas utility. Unlike the electric industry, the natural gas industry is already disaggregated, and is well along the path of deregulation with vigorous competition in most market segments. The problems posed for our industry by this archaic and duplicative securities law are real and immediate, and the remedies should not be held in abeyance while the restructuring of the electric industry is completed.

For the natural gas industry, the burdens of PUHCA are real. They exist today. We face a growing list of competitors seeking to take advantage of the deregulation of the natural gas industry by picking off our customers, while we are constrained by PUHCA from competing in and expanding domestically into the very business we know best—the provision of energy services. The new competitors—inter-state pipeline companies, gas brokering and marketing companies, and even utility companies from other States—are here today and are active in our service territory. There is no merit in granting some industry players an advantage over others based solely upon their regulatory status under PUHCA.

Managing natural gas distribution and transmission is what we have done best for more than 100 years, and it is this and the related energy services field that is our company's logical business path to growth and financial health, benefiting not just our shareholders, but our rate-payers as well. But under PUHCA, we are permitted to invest in a gas distribution system in Argentina (which we did) but essentially prohibited from owning a similar system in Arkansas. We fail to see the public interest being served by a securities statute that encourages domestic utility corporations to export capital, rather than gain the savings for customers that could flow from system efficiencies here at home.

From a practical standpoint, we also note that the FERC is involved in charting the course for wholesale competition in electricity, and many States, including our home State of California, are far advanced in addressing retail electricity competition. It is therefore not clear at this point that broad legislation regarding electric restructuring has a clear consensus, let alone that such legislation has a chance of being enacted soon. We urge you not to postpone the important action of PUHCA reform while the electric industry restructuring debate proceeds through complex and contentious issues. There is significant concern that the movement toward retail competition in States such as California may be distorted or delayed by Congress' failure to enact PUHCA repeal.

Let's move forward with an issue that is clear and has the consensus of the experts charged with administering this 60-year-old securities law. After extensive study and public comment, the SEC is urging conditional repeal (and has done so under both Democratic and Republican Administrations). In this era of reinventing Government to make it more effective and efficient, it would be most unfortunate if Congress were to fail to act on this issue. The SEC has charted a course of administrative liberalization of the Act pending congressional action. Our concern with that approach is that it is impermanent and piecemeal.

What Market Power Issues Are Raised by PUHCA Repeal?

When PUHCA was enacted in 1935, the electric and natural gas industries were still in their infant stages, the SEC was a new agency, the Federal Power Commission (the predecessor of the FERC) was created at the same time as PUHCA, and many States still did not have public utilities commissions. When the SEC undertook its study of PUHCA in 1995, the agency determined the substantial changes in Federal and State regulation made PUHCA redundant.

The question of the effect of conditional repeal of this duplicative law on market power is a false issue. Conditional PUHCA repeal does nothing to diminish the power of the FERC, the Department of Justice, or of States to intervene in mergers and acquisitions. In fact, PE's experience in the merger with Enova has clearly demonstrated that regulators look very closely at market power issues. In fact, we have had to provide extensive market information to the State Public Utilities Commission, the State Attorney General, the U.S. Department of Justice, and the FERC to address their concerns about market power. The documentation provided has shown that our merger encourages competition, and any argument to the contrary—i.e., that there is a gap by regulators in looking at market power issues—is simply specious. Interestingly, from our merger experience, we have also learned that competitors will not hesitate to raise the market power issue and ensure that their concerns are addressed.

From a natural perspective, to date the restructuring of the natural gas industry has resulted in the development of a more competitive market. Competition has reduced wellhead prices, and State public utilities commissions require distribution companies to pass through to the customers any savings received from the purchase of less costly gas. Our experience in California clearly demonstrates that adequate

safeguards are already in place at the State level to protect utility consumers. Indeed, State regulation arguably creates conditions whereby increasing the scale of distribution companies, and their buying power, would redound to the benefit of utility customers.

Conditional repeal of PUHCA promises to bring more players into the market, not fewer, by liberalizing the restraints on investing in utility operations. In the natural gas industry we have seen deregulation lead to many more players in all aspects of the industry, and we would expect the same to hold true of electricity. History has shown that when cracks are opened in PUHCA—as they were by PURPA as well as by the Energy Policy Act of 1992—new entrants have jumped in. In fact, those cracks in PUHCA have created the *only* significant competition in the electric generation market. In the case of California's restructured electric services market, concerns have been raised that the continuation of PUHCA may limit the full benefits of competition, as it will limit the generators able to sell to retail customers.

Consumer Protection Questions

In its year long analysis of PUHCA, and in the public comment process, the SEC took great pains to assure that the consumer protection concerns peculiar to multi-state holding companies were addressed. Specifically, the SEC's access to the books and records of all companies in a holding company system, and the ability to audit all companies in a holding company, would be preserved as provided for in S. 621, and the administration thereof transferred to the FERC. Thus, one Federal agency would be responsible for utility consumer protection—the FERC. Clearly, the FERC is the most appropriate Federal agency for consumer protection of rate-payers.

PUHCA is not a consumer protection statute, it is an investor protection statute. After a very extensive review, the SEC determined that in the intervening years since PUHCA was enacted, the investor protection functions of PUHCA were accomplished by the securities laws that cover all industries, and that these two industries did not require any special treatment. In addition, the SEC sought to assure, as does the bill before your Committee, that whatever information the States or the FERC may deem necessary to carry out their consumer protection role would not be jeopardized by the conditional repeal of PUHCA.

Thus, there are no real consumer protection issues with PUHCA, and claims to the contrary are simply political rhetoric.

Utility Diversification

One area that I would like to speak to directly concerns utility diversification.

PE has learned from painful experience that we should be competing with others for a greater share of the energy market business, rather than going into unrelated, non-utility businesses. The managing of natural gas distribution and transmission has been PE's core competency—it is what we have been doing best for more than 100 years—and it and related energy services is the logical business path to growth and financial health and success. The focus on energy services benefits not just shareholders, but rate-payers as well.

In the midst of a stagnant market in California, with no significant utility growth, PE sought in the late 1980's to maximize shareholder return and customer value by accelerating diversification of our business mix. Since PUHCA constrained us from out-of-state utility acquisitions, we focused upon unrelated diversification and purchased oil and gas, real estate, agriculture, and retail businesses unrelated to our core business.

For a wide variety of reasons, but mostly because our experience in natural gas distribution and transmission did not enable us to foresee and then manage the problems which were encountered by the non-utility operations, our diversification strategy failed.

By early 1993, we were no longer involved in non-utility operations. The decision to move out of the non-utility business was made after succeeding years of increasing losses that in one specific year exceeded the profits of the utility, despite our commitment to improving their performance. The continuing large losses in our non-utility operations, coupled with California's economic downturn and the prospect for continued volatility in energy prices, threatened the financial viability of our non-utility subsidiaries.

However, at no time did these losses impair the quality of utility service or utility rates, or the ability of the utility to raise capital.

PE management moved to restructure the company and return our focus toward our natural gas utility business. We sold all of the major non-utility businesses and eliminated our debt, and are now on sound financial footing, having resumed the dividend on stock (which we suspended in 1992).

It is precisely because of our unsuccessful diversification program that PE is so strongly committed to conditional PUHCA repeal. PE's best long-term prospects lie with the opportunities offered by the merger with Enova and the business competencies gained from more than 100 years of operation and experience within the energy business. These are the business operations in which we have many decades of real, hands-on experience, and we believe changes in the regulatory climate will enable us to succeed in expanding along these business lines. But we must be permitted to operate fully within the deregulated market. Without conditional PUHCA repeal, our marketplace is artificially limited.

Furthermore, the fact that PE's unsuccessful unrelated diversification effort had no impact on SoCalGas rate-payers demonstrates that adequate rate-payer protections are in place. Our experience also demonstrates the superiority of the holding company structure, which is the reason why we have long advocated its use. Were PE not a holding company but a diversified operating company such as many of the new energy competitors, rate-payers may very well have been injured, despite the best efforts of State regulators and our company. While our diversification strategy cost shareholders more than \$1 billion, it did not cost rate-payers one cent.

PUHCA comes with a high cost, and blocks efficiency gains in our Nation's energy industries.

Conclusion

Our support for the conditional repeal of the Public Utility Holding Company Act is based upon two perceptions:

- PUHCA is just no longer needed. The recognition that adequate consumer safeguards exist within the U.S. Department of Justice, the FERC, and the State commissions is the crux of our argument for conditional PUHCA repeal. We agree that 60 years ago PUHCA filled in regulatory gaps that appeared in the development of the natural gas and electric industries. The Act was one of a series of measures designed to provide Federal regulation to compensate for the lack of adequate State regulatory power. However, in the 60 years since the passage of PUHCA, effective Federal securities laws and regulations to protect investors have been enacted. The FERC has played an increasingly prominent role in inter-state regulation of energy industries, and States have developed sophisticated regulatory systems of their own to protect consumers. Therefore, today PUHCA is unnecessary.
- Retaining PUHCA comes with a high cost. The Act blocks efficiency gains in our Nation's energy industries, it limits the potential competitors, it leads to different regulatory treatment for similarly situated companies, and it contributes inefficiencies to utility investment decisionmaking.

Mr. Chairman, S. 621 represents a significant step toward eliminating the problems caused by PUHCA and helps to realize the full benefits of a more competitive energy market. We applaud and support the SEC's efforts to repeal the Act, and urge you and this Committee to move ahead to pass S. 621 so that the bill can be considered by the full Senate as quickly as possible.

PREPARED STATEMENT OF DR. MARK N. COOPER

DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

APRIL 29, 1997

Mr. Chairman and Members of the Committee, my name is Dr. Mark N. Cooper. I am Director of Research at the Consumer Federation of America (CFA). Founded in 1968, the Consumer Federation of America is the Nation's largest consumer advocacy group. Composed of over 240 State and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, the Consumer Federation of America's purpose is to represent consumer interests before Congress and the Federal agencies.

CFA has an ongoing interest and involvement in national electricity and energy policy formation. Focusing on electric utility issues in the past decade, CFA has testified before Congress, filed comments in regulatory proceedings at the Federal Energy Regulatory Commission (FERC) and before several State commissions, served on advisory boards of the Office of Technology Assessment, filed *amicus* before the U.S. Supreme Court, taken part in informal dialogues with industry representatives, sponsored an annual electric utility conference, and published several major research reports.

CFA has been especially active in regulatory reform at the Federal level, having testified before Congress and regulatory agencies regarding airline, railroad, natural gas, and telecommunications deregulation.

As the Director of Research for CFA, I have now testified before Congress and Federal agencies about utility regulation approximately 50 times. As an expert witness representing consumer organizations, low-income groups, senior citizens, People's Counsels, and Attorneys General, I have testified approximately 100 times on utility regulation before over three dozen State utility commissions. Based on our institutional background and my own real world experience, we offer the Committee a number of observations on the proposed repeal of the Public Utility Holding Company Act (PUHCA).

- PUHCA provides essential consumer protections;
- Premature repeal of PUHCA would expose consumers to abusive transactions;
- Premature repeal of PUHCA would make regulation of abusive corporate transactions and risky financial practices more difficult;
- Premature repeal of PUHCA would make the introduction of competition into the electric utility industry more difficult;
- The alleged inefficiencies created by PUHCA regulation are vastly overstated; and
- The introduction of effective competition into the industry should come before repeal of PUHCA.

PUHCA Provides Essential Consumer Protections

PUHCA provides essential protection for competition and consumers in the electric utility industry in a number of ways.

- It bars utility acquisitions which could monopolize new territories or new power sources or which create risks to consumers or investors.
- It demands that utility acquisitions "serve the public interest by tending toward the economical and efficient development of an integrated public utility system."
- It limits utility speculation in unrelated ventures, where that speculation imposes risks on electric customers.
- It guards against corporate structures that make State regulation much more difficult.
- It prohibits inter-affiliate transactions within the registered holding company systems, except at cost.
- It requires advance review of certain bond issuances of the registered holding company systems.

These requirements caused the massive holding companies of the 1920's to disintegrate because they struck at the heart of the abuses on which those companies were built. These requirements have prevented all but a handful of utility holding companies from persisting into the present. These functions are actually more important today than they have been at any time since the initial reorganization of the industry in the 1930's and the 1940's. Amid a wave of mergers and relaxation of regulation, the holding company tests embodied in PUHCA prevent the accumulation and abuse of market power.

I always find it odd that we begin the effort to inject competition into monopoly industries by eliminating competitors through a merger wave. This has happened in other industries. It is happening in electricity. Too many mergers have been allowed, but there would be many more if PUHCA were repealed. That would be bad for competition and bad for consumers.

Premature Repeal of PUHCA Would Expose Consumers to Abusive Transactions

The fundamental consumer protections provided by PUHCA prevent a wide range of abusive transactions from taking place. Regulation of transactions under PUHCA is sufficiently rigorous to dissuade most utilities from engaging in multi-state, non-contiguous, and diversified activities. As a result, PUHCA prevents the development of complex corporate holding companies which span many State and international borders and evade regulation. By imposing very rigorous regulation, PUHCA effects a structural solution. Most utilities have not done certain things to avoid coming under PUHCA. If the commitment to consumer protection embodied in PUHCA is maintained, they will not engage in these activities.

If PUHCA is repealed, this consumer protection would be lost.

- A vast array of abusive transactions, which are presently eliminated from the marketplace, would rapidly grow.

- Attention and resources will be devoted to the acquisition of assets that build market power.
- Cash would be diverted from utility operations of multi-state holding companies to diversification of activities into unrelated, speculative undertakings.

Regulators are simply incapable of preventing these abuses. Market forces are far too weak to discipline them. That is the lesson we have learned from the activities of multi-state holding companies which are not subject to the Public Utility Holding Company Act, like the Regional Bell Holding Companies. That is the lesson from the activities of electric utilities which are not subject to PUHCA.

Premature Repeal of PUHCA Would Make Regulation of Abusive Corporate Transactions and Risky Financial Practices More Difficult

I have already suggested that I believe Federal and State regulators would not be able to adequately police the transactions unleashed by a repeal of PUHCA. Let me state definitively that regulation cannot replace PUHCA's structural protections because we just do not have a comprehensive State-Federal scheme of regulation in place in this country by any stretch of the imagination.

What we have is a hodgepodge of partial and conflicting authorities. We have agencies with inadequate powers to execute the inadequate authorities that they possess. We have agencies that lack the resources to do an effective job of regulating where they have power and authority.

Repeal of PUHCA would make matters much worse. State regulators who are now already at a severe disadvantage would be faced with far-flung entities that cross States and even international boundaries.

- In many States, regulators do not have the authority to regulate these entities and the proposed law does not condition exemption from PUHCA on the granting of such authority.
- The powers that the proposed repeal of PUHCA would give them are restricted and ineffective.
- In no case do regulators have the necessary resources to effectively regulate these entities.

We do not believe that the FERC can or will provide the same level of protection as PUHCA now does. The FERC has already shown an inclination to shortchange rate-payers.

- It has deregulated long before competition is adequate to discipline any abusive behavior.
- It has defended stockholder interests at the expense of rate-payers.
- It has allowed mergers, even where it anticipates market power problems.

We doubt it would do a much better job of policing affiliate transactions and we suspect that Congress would never give it adequate resources to do a good job, even if it were so inclined. The fact that the SEC has been lax in its PUHCA implementation in recent years is not a justification for repealing the law. It should be the occasion for the congressional oversight committees to encourage regulators to do their job and also for the Administration to appoint regulators who better understand the consumer protections of PUHCA.

Thus, we do not have effective regulation today and it would be even less effective should PUHCA be repealed.

Premature Repeal of PUHCA Would Make the Introduction of Competition into the Electric Utility Industry More Difficult

I have already suggested that competition in the electric utility industry cannot prevent the abuse of rate-payers which would flow from the repeal of PUHCA. Let me state definitively that there is not sufficient competition in the industry today and that there is not likely to be sufficient competition any time soon to address the types of abuses that the repeal of PUHCA will unleash.

- There is presently a monopoly in local distribution and long distance transmission. No one realistically foresees an end to this monopoly any time in the near or mid-term.
- Local generation markets are pretty close to monopolies too. Even in the best of circumstances, incumbent franchise electric utilities obtain only a small percentage of their total generating capacity from non-utility generators.
- In no case has any State legislation required the complete divestiture of generation assets or precluded the reintegration of generation with any other utility functions as part of a restructuring plan.

Premature repeal of PUHCA would retard competition, not promote it. It would allow only a small number of huge, multi-state entities to acquire additional utilities. They would easily amass market power in regional generation markets. The largest of the exempt holding companies would quickly expand beyond their State borders, gobbling up smaller entities and reducing competition in regional markets.

Thus, vertical integration and horizontal market power are likely to persist in the electric utility industry. Repeal of PUHCA could unleash another wave of mergers. It would allow multi-state entities to gain ever greater control and influence over regional electricity markets. There is nothing in the proposed PUHCA repeal bill and nothing in other Federal legislation pending before Congress that would prevent these anti-competitive and anti-consumer outcomes.

The Alleged Inefficiencies Created by PUHCA Regulation Are Vastly Overstated

Advocates of PUHCA reform frequently complain that PUHCA's structural regulations prevent them from doing good things for rate-payers. The most frequent complaint is that PUHCA prevents the best builders from building generating facilities across the Nation. That argument is wrong for a number of reasons. Above all, the leverage that the utilities claim they need from multi-state holding companies is doubtful.

- If there are any natural advantages to being an integrated generation, transmission, and distribution entity, then utilities as presently configured will go on building if capacity is needed.
- They can expand or build power for wholesale markets if they meet the PUHCA tests.
- The highly skilled utilities could build turnkey plants as contractors for the lesser skilled utilities.
- If there are no economies of integration and there are simply a few master builders out there who should specialize in construction, then let them form truly independent companies. If they are that good, they should have no trouble raising the necessary capital and finding orders.

The other claims about PUHCA burdens are easily dismissed from the residential rate-payer point of view. Some argue that PUHCA discourages risk taking and diversification. It probably does, and that is all to the good. Electricity is a necessity. It has a low elasticity of demand. It is infrastructural in nature. Frankly, we do not want our utilities to be risk takers or to wander into other lines of business.

The claimed reward of diversification sought by the utilities, lies in its potential to strengthen the financial condition of utilities. This potential reward comes with the risk of financial weakness and cross-subsidization. The track record of diversification is mixed, at best, in both utility and non-utility industries. Our experience with diversification in telecommunications and exempt electric utilities teaches us to be cautious rather than take risks at the rate-payers expense.

The Introduction of Effective Competition into the Industry Should Come Before Repeal of PUHCA

The Consumer Federation of America firmly believes that competition is good for consumers and we have done so for decades. We have learned over the years, however, that the rhetoric of competition frequently far outstrips the reality.

- In industry after industry, Congress and the regulatory agencies have failed to deliver on the promise of competition—just listen to all the talk about rate increases for basic telephone service.
- They have ended regulatory oversight long before market forces are adequate to prevent the abuse of market power—just take a look at your cable TV bill.
- They have allowed concentration and re-monopolization to devour the potential benefits of competition—just count the number of Baby Bells or calculate the concentration ratios in the cable industry.

Nothing we have seen in Federal legislation or State-driven restructuring of the electric utility industry gives us reason to believe that competition will protect residential rate-payers in the foreseeable future. Indeed, because the monopoly core of the industry in distribution and transmission is so firm and the ability of competitors to enter the generation market is suspect, residential rate-payers have serious questions about the ability of competition to deliver benefits to them.

Under these circumstances, the repeal of PUHCA is premature. There is no reason to make matters worse and hope that Congress fixes the problem later. Repeal of PUHCA should be the last step on the road to competition in the industry, not

the first. Any repeal of PUHCA must also put structural, not functional, protections in its place to prevent the abuse of vertical and horizontal market power.

- The only way to prevent abuse of affiliate transactions is to require divestiture of potentially competitive market segments from remaining monopoly segments.
- The only way to prevent the abuse of market power in any industry segment is to impose a specific competitiveness standard—like the merger guidelines.

The public deserves no less than full regulatory oversight until effective competition is demonstrated to exist so that market forces can effectively take the place of regulation.

PREPARED STATEMENT OF LARRY A. FRIMERMAN
FEDERAL LIAISON, OHIO CONSUMERS' COUNSEL, COLUMBUS, OHIO
 ON BEHALF OF THE
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES
 APRIL 29, 1997

Summary

As a representative of utility consumers, I support any effort by Congress and regulatory agencies to align laws and regulations with current needs and practices in the electric utility industry in order to allow rate-payers to receive the benefits of a transition to a more competitive industry. The National Association of State Utility Consumer Advocates (NASUCA), however, urges Congress and the SEC not to take any action which would weaken the protections of the Public Utility Holding Company Act. Congress must first ensure that public utility holding companies are either subject to effective competition or are subject to effective regulation where effective competition does not exist or where competition would not induce efficiency, reduce costs, and advance consumer interests.

Registered holding companies and their subsidiaries are not susceptible to effective control by any single State and require Federal oversight over inter-affiliate transactions, corporate structure, diversification, and access to books and records. We recognize that neither the electricity nor the natural gas industry has a fully competitive market structure and that utility market power remains pervasive. If PUHCA were either repealed or substantially modified, neither the remaining regulatory framework nor the current state of competition would be sufficient to protect consumers. Until utility market power is eliminated, consumers must be protected by effective regulation which, in the case of multi-state holding companies, includes the provisions of PUHCA. Effective regulation must retain both rate and structural reviews, with a rational allocation of responsibility between both State and Federal regulators.

As the SEC/NARUC survey shows, there are substantial gaps and variations in existing State regulation of multi-state holding companies. These substantial gaps would need to be filled, and current regulatory problems created by the *Ohio Power* and *Mississippi Power & Light* court decisions would need to be corrected prior to congressional consideration of removal of any PUHCA protections.

In addition, PUHCA reform should really be considered in the broader context of restructuring the electric utility industry in order to ensure that an effective competitive market develops and that the benefits flow to consumers.

Introduction

Good morning, Chairman D'Amato and Members of the Banking, Housing, and Urban Affairs Committee. I am Larry Frimerman, Federal Liaison with the Ohio Consumers' Counsel, and I serve on the Electric Committee of the National Association of State Utility Consumer Advocates (NASUCA). I am here today representing NASUCA. NASUCA is an association of 41 consumer advocate offices in 38 States and the District of Columbia. Our members are designated by laws of their respective States to represent the interests of utility consumers before State and Federal regulators and in the courts. On behalf of the Office of the Ohio Consumers' Counsel and NASUCA, I wish to thank you for the opportunity to testify before this Committee on S. 621 and the future of the Public Utility Holding Company Act of 1935.

First, I would like to commend the Committee for holding this hearing and for pursuing the issues that are the subject of this morning's discussion. As we move toward a more competitive electric generation industry, it is essential that Federal and State lawmakers continue to reassess those laws and regulatory actions that

will either protect or harm consumer interests in the context of the larger debate on the structure of the industry.

The debate today is on the future of the Public Utility Holding Company Act. However, this debate cannot be examined outside the context of the entire framework of the electric utility industry without distorting market implications for consumers and competitors alike. The industry is in the midst of substantial change and uncertainty, so examination and the possible elimination of key industry underpinnings cannot be done in a vacuum. Any discussion of substantial modification of PUHCA must be considered in the context of examination and adoption of changes consistent with the establishment of an industry structure that limits market power for electricity sellers and buyers, and one in which a combination of effective competition and effective regulation protects the consumer interest.

In a series of resolutions dating back to 1983, NASUCA has urged Congress to exercise the greatest caution in response to efforts to dismantle the consumer protections contained in PUHCA. Most recently, in June 1995, NASUCA passed a further resolution that is attached to my testimony and forms the basis for my remarks here today.

Specifically, in our most recent resolution, NASUCA states its continued opposition to changes to PUHCA which would reduce consumer protections in the Act at this time. NASUCA urged Congress and the SEC not to take any action that would weaken the Act without first ensuring that public holding companies are either subject to effective competition or subject to effective regulation, where effective competition does not yet exist or where competition would not induce efficiency, reduce costs, and advance consumer interests.

Our resolution recognizes that public utility holding companies and their subsidiaries are affected with a national public interest and that their activities extending over many States, are not susceptible to effective control by any individual State. We also recognize that neither the electric industry nor the natural gas industry has a fully competitive market structure and that utility market power remains pervasive. We conclude that, if PUHCA were repealed today in the manner proposed in S. 621, neither the remaining regulatory scheme nor the current state of competition would be sufficient to protect consumers. Until utility market power is eliminated, consumers must be protected by effective regulation which, in the case of multi-state holding companies, includes the provisions of PUHCA.

In NASUCA's view, effective regulation of multi-state public utility holding companies requires both rate reviews and structural reviews, with a rational allocation of responsibility between State and Federal decisionmakers.

I would emphasize that the NASUCA resolution is not simply a call for continued or increased regulation. We specifically recognize that effective competition benefits consumers through greater efficiency and reduced costs. We also note, however, that deregulation under conditions of unfettered market power is harmful to consumers. This being the case, our resolution does not suggest that PUHCA must remain in its current form indefinitely. Rather, it cautions Congress and the SEC to take no action to weaken PUHCA without *first* ensuring that either effective competition or effective regulation is in place to protect consumers.

The NASUCA resolution is consistent with comments which were filed by seven State consumer offices, including the Ohio Consumers' Counsel, in response to the SEC's request for public input on the future of PUHCA. Those comments were also joined by a diverse group of other organizations that expressed concern over the impact of PUHCA repeal on the protection of both consumers and competition. Those groups included the American Public Power Association, the Electricity Consumers Resource Council, Consumer Federation of America, and the National Rural Electric Cooperative Association.

Those comments, filed at the SEC in March 1995, contended that, contrary to the claims of the PUHCA repeal proponents, there is neither sufficient competition nor sufficient State regulatory tools to ensure consumer protection in the absence of PUHCA. It is beyond dispute that utilities retain substantial market power in the distribution and transmission functions and, to a substantial extent, in the generation function as well. In addition, the comments noted, State regulation is not in a position to deal with the number and the complexity of multi-state restructuring transactions that would arise if PUHCA were repealed. The comments stated:

Our purpose is not to argue against all change to the Public Utility Holding Company Act. We instead describe the facts which repeal advocates must show to make their case, and to explain the conditions which must be in place if amendment or repeal is to advance the consumer and their public interest.

Unfortunately, I believe that the concerns expressed by this diverse group of organizations were not adequately addressed in S. 621 or in the 1995 SEC report on PUHCA upon which the bill appears to have been based.

S. 621 would significantly worsen the problems associated with monopoly power. For example:

- (1) Repeal of PUHCA's integration requirement:
 - Weakens the ability of State regulators to protect the rate-payers (and State economies) from monopoly abuse. A State's ability to ensure least cost service is further confounded when the franchise owner is headquartered in another State or country.
 - Opens the door to expanded opportunities for forum shopping and also for Federal pre-emption of State commissions in the assignment of generation or other costs which could be required by the FERC in light of the *Mississippi Power & Light* court decision.
 - Could increase the potential for nationwide or regional market concentration through unrestricted acquisitions of noncontiguous utilities by companies already holding substantial market power without competition for, or in their own service territories.
- (2) With repeal or easing of restrictions on utility diversification, the complexity of tracking and allocating costs and preventing cross-subsidization reaches a new level of difficulty. The goal of PUHCA modernization should be to reduce overly burdensome regulation. By repeal of PUHCA diversification provisions, S. 621 would have the opposite effect by increasing the regulatory burden.
- (3) There will be a significant increase in complex holding company structures. This would make it much more difficult to detect and to deflect inappropriate inter-affiliate transactions between competitive and monopoly business components, or to prevent any conflicts of interest, anti-competitive behavior, or other market power abuses.
- (4) As a result of their retail franchises and access to customers and information, electric utility holding companies retain an unmistakable advantage in many non-utility markets. Without addressing the fundamentals of this market power problem, S. 621 would permit utilities to harm competition in both utility and non-utility businesses. As an end result, economic efficiency would be reduced, consumers harmed, and small companies put out of business.
- (5) As evidenced in the SEC survey of State utility commissions, many State regulators lack adequate authority to fill in regulatory gaps left by PUHCA repeal. Moreover, even if States have legal authority to fill the gaps, they may not have the resources, particularly as franchise owners become highly diversified and geographically distant, as S. 621 would permit.

We applaud the Chairman for recognizing the need for a continued Federal presence in policing inter-affiliate transactions, audits, and access to books and records. However, the measure falls short in providing all of the necessary tools to the FERC with respect to policing inter-affiliate transactions, and even exempts key affiliates from having to provide access to books and records. Moreover, S. 621 eliminates two provisions, the provisions addressing diversification and the integration limitations, which remain at the heart of the Act today despite the representations of some registered holding companies.

Proponents of repeal or major modification of PUHCA have incorrectly characterized the nature of the electricity industry today: It is not, as is claimed, a competitive industry. Furthermore, State regulation is not, contrary to statements of repeal proponents, sufficient to protect the consumers in the absence of a Federal statute regulating multi-state public utility holding companies.

The factor motivating Congress in 1935, "market power," still exists 60 years later. Since 1935, the structure of the industry has been greatly influenced by the Act. Changes in PUHCA, without ensuring effective competition and effective regulation in those sectors where each (or both) is appropriate, will harm consumers.

Market Power

Congress and Federal agencies must address the need to mitigate market power. The exercise of market power is likely in industry structures that include natural monopolies over essential facilities such as transmission and distribution systems, or in joint ownership of monopoly and potentially competitive businesses. In the electricity industry today, these conditions remain. In fact, S. 621 would permit any electric utility or gas utility to acquire disparate utilities. These conditions are not present in, for example, other industries, where there is no exclusive franchise to sell at retail. If Congress repeals PUHCA and its integration requirement without tying relief to a showing of effective competition or divestiture, then these very large

utility companies can expand their monopoly customer, billing, transmission, and distribution monopolies at will to ward off competitors. This places such utilities at a tremendously unfair advantage prior to the onset of competition and will allow the utility to acquire other utilities and their service territories without facing competition within their own service territory or realistically being subject to acquisition by even larger competitors. Contrary to claims you may hear, the entry of *wholesale* generators does not necessarily reduce the impact of monopoly status for captive *retail* customers. Nor does EPAct tie the hands of electric utilities. Congress specifically provided broad EWG exemptions, as well as more limited exemptions for foreign utility investment, to accommodate a move toward competition in bulk power markets.

Where there are monopolies, especially with Government-granted utility service franchises, the primary obligation is to core customers. No costs associated with an off-system investment, or with regulating such an investment to protect captive customers, should be borne by rate-payers. Unfortunately, effective means for denying the pass-through of unwarranted inter-affiliate costs for multi-state holding companies do not always exist at the State level. In fact, the *Mississippi Power & Light* court decision (*Mississippi Power & Light Co. ex rel. Moore*) places consumers at continued and expanded risk from harm as a result of inappropriate costs potentially being allocated by a Federal agency even if the State has denied prudence of such costs. This is particularly the case as holding companies acquire disparate service territories. S. 621 does nothing to correct this regulatory gap. The very existence of such a regulatory gap will place consumers at risk.

Proponents of repeal argue that structural review is unnecessary because rate regulators can protect consumers. This is simply not the case. Rate review and structural review are complementary, and both are vital in ensuring fair rates and in preventing abuses. For example, PUHCA prevents holding companies from abusing corporate form to benefit their shareholders at the expense of consumers and competitors. They were designed as such when Congress enacted the twin Federal Power Act and PUHCA statutes. After-the-fact rate regulation alone cannot prevent or correct large investment errors, which may harm the rate-payers and the general public.

Second, all the necessary tools may not be within the State commission's authority. For instance, the SEC/NARUC survey indicates that many States lack the legal authority to prevent certain out-of-state affiliations by a holding company located in another State, but owning the operating utility in the PUC's jurisdiction. In addition to the *Mississippi Power & Light* decision, other gaps include *Ohio Power v. FERC*, 954 F.2d 779 (D.C. Cir.), *cert. denied*, 113 S.Ct. 483 (1992). While S. 621 appears to address the *Ohio Power* gap prospectively, it does nothing to address the regulatory gap created by *Mississippi Power & Light*.

After all, it's PUHCA itself, with its structural protections, the outright bans of certain actions, transaction, and behaviors, that cannot be replaced or matched by S. 621 or other poor substitutes. There are some parts of PUHCA which still prevent anti-competitive and anti-consumer behavior.

Finally, the States may not be the only appropriate jurisdictions to decide when a particular acquisition of a distant utility creates too much market power or concentration of control. So, structural regulation of multi-state holding companies still requires a Federal role in addressing inter-affiliate transactions, the acquisitions of non-utility subsidiaries, the acquisitions of distant utility companies, and mergers. Given current flaws in the structure of electricity markets, these changes are too substantial to adopt without ensuring the appropriate mix of effective regulation and effective competition.

If you look at who is for and who is against stand-alone PUHCA repeal, it should tell you who wins and who loses. The only proponents of repeal are most of the registered holding companies and the SEC. The opponents of repeal include all major consumer groups, all user groups, representing residential, commercial, and industrial customers, heating and air conditioning contractors, municipalities and cooperative organizations, State utility commissioners, Consolidated Natural Gas, and other organizations. It is not, as portrayed at last year's hearing, everyone but NASUCA and ELCON in support.

Conclusion

I would like to conclude by urging the Committee to consider the assessment of the Public Utility Holding Company Act only in the context of the larger structure of the industry and specifically with respect to adopting any changes to the Act. As you have heard, the industry is evolving. We must first determine the appropriate market structure and nature of competition within the industry to evaluate the appropriate methods for balancing effective competition and effective regulation. If this

is not achieved, consumers will not benefit, and will likely bear the brunt of any deregulatory actions.

NASUCA urges the Committee not to repeal or weaken the consumer protections in PUHCA as embodied in S. 621 without first ensuring that public utilities are subject to effective competition, or effective regulation, where competition would not induce efficiency, reduce costs, and advance the interest of consumers. S. 621 does not meet such a standard.

Such legislation is inappropriate. In virtually every statehouse, at virtually every commission, there is legislation, joint committee proceedings, and other proceedings. However, it is still unclear what will be the outcome in many States. There may or may not be retail competition in several States. But we do know that the world is evolving in ways in which we cannot anticipate the results. To repeal the anti-empire building statute at such a time when structural abuses could become the order of the day would be folly.

Thank you again for the opportunity to speak on behalf of NASUCA and the Ohio Consumers' Counsel.

National Association of State Utility Consumer Advocates
Air Conditioning Contractors of America
Public Citizen
National Alliance for Fair Competition
American Public Power Association
Electricity Consumers Resource Council
Transmission Access Policy Study Group
City Council of New Orleans
Missouri Basin Municipal Power Agency
Northern California Power Agency

May 16, 1997

The Honorable Alfonse D'Amato
 Chair
 Senate Banking, Housing and Urban Affairs Committee
 534 Senate Dirksen Building
 Washington, D.C. 20510

Dear Chairman D'Amato:

Attached is a statement of Consumers for Fair Competition for the record of your committee's April 29 hearing on the Public Utility Holding Company Act of 1997 (S. 621).

Our coalition has serious concerns about the impact of market power on the electric utility industry. We strongly oppose S. 621 as it would disadvantage consumers by substantially increasing the risk of market power abuses in the electric utility industry. Our primary concerns are as follows:

- S. 621 will lead to increased merger activity in an already highly concentrated electricity marketplace. The resulting increased concentrations of market power could prevent development of structural competition in the electricity industry.
- The authorities S. 621 proposes transferring to the Federal Energy Regulatory Commission and state public utility commissions in the absence of PUHCA are too limited. Consumers would be placed at risk due to the elimination of important existing regulatory authority over the corporate structure of multi-state holding companies.
- Passage of S. 621 by itself will subject thousands of small businesses to unfair cross-subsidized competition from some of the largest domestic utility companies. PUHCA should not be repealed until effective competition in the electric utility industry has taken hold, and sufficient safeguards against subsidization and self-dealing are in place.
- Without structural competition in the electric industry, captive customers will have no ability to avoid carrying the financial burden of failed holding company diversification efforts, poor business decisions and cross-subsidies. Thus, elimination or reform of existing consumer protections such as PUHCA should only be considered in the context of comprehensive industry restructuring legislation.

We appreciate your consideration of our views regarding S. 621.

CONSUMERS OPPOSE S. 621, THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1997

REPEALING EXISTING CONSUMER PROTECTIONS OF PUHCA WILL SABOTAGE
COMPETITION IN THE ELECTRICITY INDUSTRY AND EXPOSE UTILITY
RATEPAYERS TO MARKET POWER ABUSES

I. The nation's large multi-state holding companies would have you believe that the Public Utility Holding Company Act (PUHCA) should be repealed as it disadvantages consumers by inhibiting competition in the electric utility industry. The fact is, there is not one major electricity consumer group, large or small, that supports repeal of PUHCA as proposed by Senator Alfonse D'Amato in his bill S. 621, the Public Utility Holding Company Act of 1997. Moreover, a significant number of consumer groups – from residential to large industrial consumers – strongly oppose repeal of this statute. The only constituency advocating PUHCA repeal is the holding companies themselves – the special interests that stand to benefit from being unleashed from public accountability.

II. Proponents of PUHCA repeal claim that S. 621 is an important first step toward the deregulation that is necessary to establish competition in the electricity industry. It is on this basis that they claim that the bill is "pro-consumer." The fact is that S. 621 is sure to inhibit, if not prevent, the advent of structural competition in the electricity industry by enabling today's monopoly utilities to garner even greater amounts of market power before competition can get a foothold in the industry. This outcome will hurt – not benefit – consumers.

By eliminating a number of important existing regulatory authorities related to corporate structure, S. 621 will lead to massive consolidation in the electricity industry. Specifically, by lifting the requirement that utility operations be geographically integrated, mergers will become much more frequent as utilities will have the ability to create cross-country mergers using the holding company structure. An increase in merger activity would exacerbate the already growing trend toward consolidation in the industry as utilities are seeking to gain economies of scale in a future competitive marketplace. By creating new potential for market power concentration within the electricity industry prior to the advent of competition, S. 621 will make a transition to structural competition difficult, if not impossible.

True competition can exist only where there is no market power. By concentrating market power in the hands of a few, S. 621 will sabotage competition by tilting the competitive balance within the electricity industry in favor of the largest players who are already entrenched with numerous market advantages unfair to consumers.

III. Sponsors of the bill claim it preserves important regulatory provisions of PUHCA by transferring existing SEC authority to the Federal Energy Regulatory Commission (FERC) and state public utility commissions. However, the regulatory oversight authorities that S. 621 proposes transferring to FERC and the state commissions in the absence of PUHCA are related only to their jurisdiction over electricity rates and are thus ineffective and inadequate to protect electric utility consumers. The regulatory requirements and restrictions under PUHCA are enough to dissuade most utilities from utilizing the multi-state holding company structure and to focus the activities of the 15 multi-state holding companies on their core utility business. S. 621 will substantially weaken this consumer protection by transferring only limited amounts of existing SEC authority to FERC and state public utility commissions.

Although FERC contends that rate regulation will sufficiently protect ratepayers, the ultimate protection of retail consumers falls on the shoulders of state regulators. Moreover, ratemaking authority cannot protect consumers before failed diversification, cross-subsidization and bad investments occur. It is PUHCA's structural protections, being eliminated under S. 621, that are needed to anticipate and prevent such activities.

While the existing authority of state commissions would be slightly augmented by S. 621 through the additional authority to review the books and records of subsidiaries and affiliates, state commissions are still preempted from reviewing many costs due to the existing judicial precedent set by the Mississippi Power & Light case. Moreover, many state Commissions will not have the resources or ability to monitor far-reaching interstate holding company activities.

In testimony before the Senate Banking Committee, state regulatory commissions have raised concerns about the ability of state regulators to track utility holding company activities. In fact, they have stated that PUHCA reform or repeal "must be considered in conjunction with broader changes to the Federal Power Act that support state and FERC efforts to provide utility consumers with options in emerging competitive markets."

Finally, even where FERC or an affected state commission denies, or is likely to deny, cost recovery to protect consumers, the holding company could ultimately attempt to recoup the denied costs in stranded cost relief.

IV. The provisions in S. 621 related to state access to books and records of holding companies are unworkable and ineffective. The bill requires that holding companies "shall produce for inspection books, accounts, memoranda and other records that have been identified in reasonable detail in a proceeding before the state commission...and are necessary for the effective discharge of the responsibilities of the state commission with respect to such proceeding." First, the fact that the records must merely be made available for inspection could require state regulators to travel to distant corporate headquarters to review records – an unlikely scenario given limited state regulatory resources. Secondly, the fact that the records must first be identified in detail by the states also raises questions – without first seeing the records, how can one determine which specific records are necessary for thorough state oversight? Finally, the requirement that a formal state proceeding related to a holding company must be underway before regulators can request books and records will prevent states from conducting ongoing monitoring of holding company activities.

V. *Because it so seriously weakens and impairs the regulatory safety net that protects consumers from market power abuses at the hands of the large multi-state holding companies, S. 621 would increase the risk of cross-subsidization between the regulated side of utility holding company businesses and their unregulated business activities.* As a result, captive utility ratepayers may find themselves with higher rates as they subsidize the company's activities in other areas – even foreign ventures – without receiving any benefits or services in return. This potential cross-subsidization would subject thousands of small businesses to unfair competition from multi-state holding companies.

VI. *PUHCA must not be repealed until effective competition has taken hold in the electricity industry.* The potential for consumer abuse, if PUHCA were repealed, is real. Captive consumers have no ability to avoid carrying the burden of failed diversification efforts, poor business decisions and cross-subsidies. Unless a retail consumer can escape these practices through selection of an alternative energy supplier, continued structural regulation of the electric utility industry is needed.

State and federal policymakers are now considering issues related to restructuring of the electricity industry. The trend toward competition is growing, and many changes in the industry are expected during the coming years. Effective competition must be implemented before important consumer protections such as PUHCA can be eliminated. Therefore, proposed reforms to PUHCA should only be considered in the context of comprehensive industry restructuring legislation.

Prepared and Distributed by: Consumers for Fair Competition,
a coalition working to prevent market power abuse in the electric utility industry.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO
FROM ISAAC C. HUNT, JR.**

Q.1. How much authority to approve the acquisitions, the mergers, and diversification by utility holding companies does your agency exercise? What are some of the things your agency considers in reviewing these transactions? Do you look at market power issues in approving acquisitions?

A.1. The SEC has comprehensive authority over the utility and non-utility acquisitions of registered system companies and acquisitions by other parties that result in utility affiliations. Section 9(a) of the Public Utility Holding Company Act of 1935 (1935 Act) requires SEC approval of (1) an acquisition of securities or utility assets, or any other interest in any business, by a registered holding company and its subsidiaries,¹ and (2) an acquisition of utility securities by any person if that person is, or would thereby become, an affiliate of more than one utility company.² These requirements duplicate other regulation at both the Federal and State level in some important respects.³

Section 10 of the 1935 Act requires the SEC to consider a number of factors and issues in determining whether to approve these transactions. The following standards of the 1935 Act apply to review and approval of the transactions mentioned above:

(i) *Acquisition of securities or utility assets:* Section 10(a) specifies the information to be included in an application for approval of these transactions. Section 10(b) requires that, if applicable State laws are complied with, the SEC will approve an acquisition unless it finds that:

- The acquisition will tend toward interlocking relations or the concentration of control of utilities detrimental to the public interest or the interest of investors or consumers;
- The consideration and fees paid in connection with the acquisition is not reasonable or is not fair in relation to the sums invested or the earning capacity of the assets to be acquired; or
- The acquisition will complicate the capital structure of the system or be detrimental to the public interest or the interest of investors or consumers or the proper functioning of the holding company system.

¹Section 9(a)(1) of the 1935 Act.

²Section 9(a)(2) of the 1935 Act. An "affiliate" is defined under section 2(a)(11) of the 1935 Act as any person that directly or indirectly owns 5 percent or more of the outstanding voting securities of a public utility company.

³The Federal Energy Regulatory Commission (FERC) has jurisdiction to review and approve any sale, lease, merger, or consolidation by utilities of jurisdictional facilities and any acquisition by a utility of securities of another utility, Federal Power Act, § 824b, and its review largely parallels the review by the SEC. A very substantial number of State commissions also have jurisdiction over combinations of utility companies, through authority to review mergers and/or acquisitions of utility assets and securities. According to a survey of the National Association of Regulatory Utility Commissioners, conducted in conjunction with a June 1995 staff report of the SEC's Division of Investment Management on the future of utility holding company regulation, 33 of the 43 commissions responding to the question indicated that they have jurisdiction over utility mergers; 30 of 43 respondents stated that they regulate acquisitions of utility assets; and 35 respondents indicated jurisdiction over utility acquisitions in at least some factual situations. Fewer States have prior approval authority over non-utility diversification: In a telephone survey following up on responses to the NARUC survey, 12 of a total of 43 State commissions responding indicated that they have jurisdiction over diversified activities of utilities in addition to the ability to disallow diversification costs and losses in the context of rate-making.

Section 10(c)(1) further provides that the SEC may not approve an acquisition which would contravene certain State laws with respect to ownership of combination gas/electric utilities, or that would be detrimental to carrying out the provisions of section 11, including the requirement that the operations of a registered holding company system be limited to a single integrated utility system⁴ and certain additional systems and incidental businesses. Section 10(c) also requires the SEC to find that a proposed acquisition will serve the public interest by tending toward the economical and efficient development of an integrated utility system.

(ii) *Acquisition of interests in "other" businesses:* Non-utility acquisitions are also subject to the relevant standards of section 10, discussed above, including the requirement that the acquisition not be detrimental to carrying out provisions included in section 11. Section 11 of the 1935 Act limits the "other," i.e., non-utility, businesses in which a registered holding company and its subsidiaries may engage to those that are "reasonably incidental, or economically necessary or appropriate" to the operation of the integrated utility system, on a finding that they are "necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the functioning of such system or systems."⁵ The Commission interpreted these provisions strictly in the early years of its administration of the 1935 Act, to carry out the statutory purposes.⁶ In recent years, the Commission has construed section 11(b) more expansively, consistent with the statutory purposes, in response to changes in the utility industry.⁷

With respect to the issue of market power, the possibility of increased utility merger activity after repeal of the 1935 Act was considered in arriving at the 1995 staff report's recommendation to repeal the statute. The 1935 Act does provide an additional layer of regulatory approval for certain utility mergers which may act as a disincentive to some business combinations or attempted takeovers. The report concluded, however, that this layer of approval is no longer needed.

As noted above, the FERC also has jurisdiction to review some utility mergers and acquisitions. In some cases, the matters reviewed by the two agencies overlap and separate consideration of these matters by each would be duplicative. Both the SEC and the FERC consider, among other things, the effect of the proposed transaction on competition.⁸ In recent years, the SEC has looked to the FERC's analysis of issues which are closely linked to oper-

⁴Section 2(a)(29) defines an "integrated public utility system" separately for gas and electric systems. In general, the definitions speak in terms of geographic integration and coordination of operations and, in the case of electric systems, physical interconnection.

⁵Section 11(b)(1) of the 1935 Act. The language cited is that of the so-called "other business" clauses.

⁶As the June 1995 staff report notes, unsuccessful diversification was one of the factors that led to the financial difficulties of many holding companies prior to enactment of the 1935 Act.

⁷Many activities that are classified as "other" businesses under the 1935 Act are becoming integral parts of the modern utility business. For instance, the marketing and brokering of energy commodities, and the provision of energy and demand side management services, have become important components of utility operations and, as such, have been approved by the SEC in many cases. See, e.g., *New England Electric System*, SEC Release No. 35-22719 (Nov. 19, 1982), *Consolidated Natural Gas Co.*, SEC Release No. 35-26512 (April 30, 1996), and *SEI Holdings, Inc.*, SEC Release No. 35-26581 (Sept. 26, 1996).

⁸As noted above, under section 10(b)(1) of the 1935 Act, the SEC must consider whether a proposed merger or acquisition would tend toward interlocking relations or the concentration of control of utilities detrimental to the public interest or the interest of investors or consumers.

ations, including issues that are related to competitive effect and market power, and has deferred to the FERC's expertise in this area.⁹ Moreover, the possible anti-competitive effects of proposed utility mergers are also reviewed by many States¹⁰ and by the Department of Justice and the Federal Trade Commission. The SEC often confers with these entities on issues related to competitive effects of proposed transactions. The June 1995 report recommended that the SEC continue to "watchfully defer" to the substantive findings of other agencies in appropriate cases.

Q.2. The Federal Energy Regulatory Commission has stated in testimony that they do not need, nor want, additional authority to conduct prior approval of affiliate transactions. Considering the FERC's position, do you think it is necessary that the legislation include this additional authority?

A.2. The Commission continues to believe that some Federal oversight of affiliate transactions among companies in holding company systems may be needed to prevent abuses. Upon repeal of the 1935 Act, companies in holding company systems may, depending on applicable State law, be freer to acquire interests in diversified businesses. If this should occur, a greater number of non-utility companies in holding company systems may sell goods or services to their sister utility companies. Because we cannot predict the nature and extent of these services, some of which may go far afield from the traditional utility business, the SEC continues to support giving the FERC the ability, though not the obligation, to take a closer look at these transactions in appropriate circumstances. We recognize, however, that the FERC will be the agency charged with administration of the new Holding Company Act, and we defer to its judgment as to the tools it will need in order to fulfill its regulatory responsibilities.

Q.3. In your opinion, what are the effects of this legislation on the ability of companies, States, and Federal regulators to restructure as the energy industry moves toward competition and deregulation? What would be the effect on energy deregulation in general, and on the registered holding companies specifically, if PUHCA is not repealed?

A.3. Utility industry deregulation and restructuring are creating novel issues under the 1935 Act. Formation of "independent system operators" to operate transmission grids throughout the country is underway,¹¹ various State initiatives encouraging customer choice and separation of generation assets from other utility property are being considered or implemented,¹² alternative energy suppliers are participating in increasingly competitive energy markets, and

⁹ See, e.g., *Cinergy Corp.*, SEC Release No. 35-26146 (Oct. 21, 1994); and *Entergy Corp.*, SEC Release No. 35-25952 (Dec. 17, 1993).

¹⁰ See note 3 above.

¹¹ Formation of these entities is encouraged by FERC Order No. 888.

¹² See, e.g., "California to Let Small Customers Pick Their Power Suppliers in '98," *New York Times* (May 7, 1997), at D1 (California expedites plan to allow customers to choose electricity suppliers); and *Rhode Island Utility Restructuring Act of 1996*, discussed in "R.I. Gov. Almond Signs Nation's First Bill Establishing Retail Wheeling," *Electric Utility Week* (Aug. 12, 1996) (discussing State legislation that calls for retail choice and for "corporate unbundling to create a firewall between utility affiliates").

utilities are beginning to separate the regulated and competitive portions of their utility business.

The 1935 Act was not written in contemplation of the types of activity that are taking place in the 1990's: It reflects a model of vertically-integrated monopolies, and its core definitions can operate in unexpected ways as the industry departs from this model. These developments raise issues concerning the need for registered holding companies to obtain approval to restructure their operations and engage in new utility-related activities, and the integration of their utility properties after restructuring. They also raise questions concerning the status of various industry participants as utilities and holding companies.

A "public utility company" under the 1935 Act, for example, includes any entity that owns or operates facilities for the distribution of gas at retail or facilities for the generation, transmission, or distribution of electric energy for sale. A "holding company" is defined to include an entity that has at least a 10 percent or more voting interest in a public utility. Under these definitions, absent an available exemption, the entity that holds title to the relevant physical assets, such as a generating company, is technically a utility under the 1935 Act, even though it may not sell electricity or gas, and its parent is technically a utility holding company, each potentially subject to the full range of regulation under the 1935 Act.¹³ The very same result holds for an entity such as an independent system operator that operates, but does not own, the physical assets.

At the same time, the actual seller of the energy commodity itself, if it owns or operates no facilities, may escape the 1935 Act regulation. The staff of the Commission has generally concluded that despite its contracts for the sale of gas or electric power, an energy marketer is not a public utility under the 1935 Act.¹⁴ Issues concerning the scope of permissible activities, and the effect of additional activities on non-utility status of a marketer, continue to arise.

The interplay of the 1935 Act with restructuring initiatives is expected to be a major focus of applications and interpretive questions in the coming years. It is difficult to predict the ways in which the 1935 Act could apply to or impede these restructuring developments, which participants in the energy market will be subject to its regulation, and which will escape. It is clear, however, that there will be interplay, and that issues in this area will continue to be complicated and fact-specific. There is a possibility that, in some cases, the result may be inconsistent with not only the realities of the utility industry, but also with the energy policies of the individual States and the FERC.

S. 621 would eliminate the tension between the 1935 Act and developments in the industry, by largely eliminating the regulatory framework of the statute.

¹³ This regulation includes compliance with the integration requirements of section 11 (discussed above).

¹⁴ See, e.g., *Norstar Energy L.P.*, SEC Staff No-Action Letter (Feb. 9, 1995); and *Enron Power Marketing, Inc.*, SEC Staff No-Action Letter (Jan. 5, 1994). In contrast, the FERC considers power marketers to be utilities under section 201(e) of the Federal Power Act, and regulates them accordingly.

Q.4. The SEC recently issued Rule 58, to allow public utility holding companies to acquire energy related subsidiaries without prior approval. With this new rule, holding companies will be better able to diversify and adapt to the changing landscape of the energy industry. In light of the SEC's continuing administrative actions, do you still recommend conditional repeal over administrative action to change PUHCA? Why?

A.4. As the June 1995 report noted, the SEC has long recognized that the current regulatory system imposes significant costs, in direct administrative charges and foregone economies of scale and scope, that often cannot be justified in terms of benefits to utility investors and consumers. In many respects, developments in other Federal and State regulation and in the financial markets and the utility industry have created a pervasive system of investor and consumer protections that obviate the need for many of the specialized provisions of the 1935 Act.¹⁵ As a result of that, the report concluded that the 1935 Act should be repealed, conditioned on preservation of some provisions which still continue to provide consumer protections.¹⁶

Pending congressional action to either repeal or substantially amend the 1935 Act, the SEC staff proposed a number of administrative reforms in order to modernize and to simplify regulation, to reduce the delay inherent in administration of the 1935 Act, and to minimize regulatory overlap, in each case consistent with the purposes of and protections mandated by the 1935 Act. Rule 58, adopted by the SEC on February 14, 1997,¹⁷ was a major component of these administrative reform proposals. These reforms were intended as interim measures, and the SEC still believes that, pending legislative action, implementation of administrative reforms is appropriate.

There are limits, however, to the extent to which the interpretation of the 1935 Act can be liberalized to accommodate changes in the industry, and some beneficial activities may be precluded. Moreover, only companies in registered holding company systems are subject to these limitations, while exempt holding companies and stand-alone utility companies can engage freely in various activities, including diversification into non-utility businesses, subject to any applicable State regulation.¹⁸ Repeal of the diversification restrictions of the 1935 Act would level the competitive playing field. The SEC will streamline regulation wherever possible and appropriate, but it cannot repeal the 1935 Act through administrative action. Repeal is the exclusive province of Congress.

Please let us know if further information is desired.

¹⁵In the early 1980's, the SEC determined that the purposes of the 1935 Act had been achieved and recommended to Congress that the Act be repealed.

¹⁶The 1995 report concluded that the 1935 Act continues to play a role in protecting energy consumers. Most importantly, the SEC can obtain, audit, and oversee a multi-state holding company system's books and records, particularly in regard to affiliate transactions. The staff therefore recommended that Congress repeal the statute and, at the same time, enact new provisions to ensure access to books and records required for the effective discharge of the FERC's and the States' regulatory responsibilities and to establish Federal audit authority and oversight of intrasystem transactions.

¹⁷SEC Release No. 35-26667 (Feb. 14, 1997), 62 Fed. Reg. 7900 (Feb. 20, 1997).

¹⁸See note 3 above.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO
FROM SUSAN TOMASKY**

Q.1. How much authority to approve the acquisitions, the mergers, and diversification by utility holding companies does your agency exercise? What are some of the things your agency considers in reviewing these transactions? Do you look at market power issues in approving acquisitions? Under S. 621, what additional authority, if any, is needed to protect consumers from market power abuses?

A.1. Section 203 of the Federal Power Act. The Commission doesn't have authority under the Natural Gas Act to approve acquisitions, mergers, and diversifications by natural gas companies. However, as discussed below, the Commission does have authority under the Federal Power Act (FPA) over certain acquisitions, mergers, and dispositions of jurisdictional facilities by public utilities.

Under section 203 of the FPA, no public utility shall sell, lease, or otherwise dispose of all or part of its facilities subject to the jurisdiction of the Commission if the value is in excess of \$50,000, unless it first obtains authorization from the Commission. No public utility shall by any means whatsoever, directly or indirectly, merge or consolidate jurisdictional facilities or any part thereof with those of any other person, or purchase, acquire, or take any security of any other public utility, unless it first obtains authorization from the Commission. The Commission must approve a proposed disposition, consolidation, acquisition, or change of control if, after notice and opportunity for hearing, it finds the proposal will be consistent with the public interest.

Section 203 focuses on activities that involve facilities subject to the jurisdiction of the Commission. Under section 201 of the FPA the Commission has jurisdiction over transmission facilities used in inter-state commerce and facilities used for sales at wholesale in inter-state commerce, but does not have jurisdiction over facilities used for the generation of electric energy, local distribution, transmission of electric energy in intra-state commerce, or transmission of electric energy consumed wholly by the transmitter, except as specifically provided in the FPA.

Jurisdiction Over Holding Company Mergers. The Commission has broadly interpreted its section 203 jurisdiction. It recently issued orders in the Enova/Pacific Enterprises and NorAm/Houston Industries merger cases (copies enclosed) which clarify that if there is a change in control of a holding company that owns or controls jurisdictional facilities, there is in turn a change in control, and therefore a disposition, of jurisdictional facilities which requires section 203 authorization. This interpretation applies whether the holding company itself directly owns or controls jurisdictional facilities or whether its subsidiary owns or controls such facilities. It also applies whether the facilities are physical facilities such as transmission lines or whether they are so-called "paper facilities" such as those of a power marketer. Further, where two holding companies merge and where both own or control jurisdictional facilities, there not only is a jurisdictional disposition of those facilities through a change in control, but there is also a jurisdictional indirect merger of those facilities.

I note that this clarification of the Commission's authority has not yet been tested in the courts. The Commission is confident that

its authority would be sustained upon judicial review. So long as the Commission is able to use its section 203 authority to reach changes of control effected through holding companies, there is no need for additional authority to address market power issues raised by utility mergers.

The Merger Policy Statement. On December 18, 1996, the Commission issued a merger policy statement which revised and updated its criteria for evaluating proposed mergers. Under the policy statement the Commission evaluates three factors in determining whether a proposed transaction is in the public interest: (1) effect on competition; (2) effect on rates; and (3) effect on regulation. The most complex of the three factors is the effect of a proposed transaction on competition. The Commission analyzes very carefully the increased market power and anti-competitive effects which may result from a proposed merger and potential remedies to mitigate increased market power and anti-competitive effects. The Commission has the authority under section 203(b) of the FPA to condition merger approval on the applicant's agreement to undertake adequate remedies. It also has authority to deny a merger if there are no adequate remedies.

The policy statement adopted the Department of Justice/Federal Trade Commission merger guidelines as the analytical framework for analyzing the effect of a merger on competition. The analysis is more rigorous than the one used by the Commission in the past. It more precisely identifies geographic and product markets and relies on a delivered price test analysis. It also provides a discussion of potential remedies to mitigate increases in market power caused by certain mergers. A duplicate of the merger policy statement is enclosed.

Diversification. The Commission doesn't directly regulate "diversification" by electric utility holding companies to the extent that term is used to connote investments or ventures involving nonregulated activities such as real estate, home improvement businesses, etc. Similarly, the Commission does not directly regulate any such diversification by the natural gas holding companies. However, the Commission does have the authority to ensure that jurisdictional rates for transmission and wholesale sales of electric energy, and for natural gas transportation, do not cross-subsidize the costs incurred in nonregulated businesses of public utilities and natural gas companies and their affiliates. The Commission monitors potential cross-subsidization through accounting audits of books and records of jurisdictional companies and through analysis of rate increase filings made by public utilities and gas pipelines.

S. 621 provides the Commission with sufficient additional authority to review the books and records of holding companies and their affiliates so the Commission can prevent cross-subsidization and affiliate abuse that harms rate-payers. Thus, once a merger, disposition, or acquisition is consummated, the Commission will have the tools to monitor potential post-transaction abuses.

Q.2. The SEC indicated that it was concerned that companies not be allowed to fund diversification through affiliate transactions. The SEC suggested that the FERC should have broad authority to oversee transactions among affiliates and possible prior review and approval of affiliate transactions. Does the FERC need any addi-

tional authority to protect consumers from cross-subsidization of non-utility business by the utility and the rate-payer?

A.2. The Commission does not need additional authority if S. 621 is enacted. By repealing the existing Public Utility Holding Company Act (PUHCA), Congress would eliminate a significant impediment to effective FERC regulation of affiliate transactions, that is the pre-emptive effect of PUHCA on the Commission's exercise of its authorities under the Federal Power Act embodied in the *Ohio Power* court decision. The grant of additional authority to obtain access to books and records, in conjunction with the Commission's existing authority over books and records and over jurisdictional rates and contracts affecting those rates, are sufficient to monitor and remedy affiliate abuses that could result from diversified business activities.

From time to time, a jurisdictional utility has requested the Commission to give prior regulatory approval to the rate treatment for affiliate transactions, *i.e.*, to determine in advance whether the costs to be paid in an affiliate transaction are prudently incurred. While there is nothing that prevents the Commission from before-the-fact prudence review, it has thus far declined to do so. Prior review requires some measure of speculation and is therefore less reliable from a rate-payer protection point of view than addressing issues in a rate case where actual costs can be considered. Moreover, the Commission has no special expertise that would permit it to evaluate particular business investment decisions. Therefore, the most effective regulatory safeguard is to ensure that the costs and risks of diversification are properly assigned to shareholders through the rate-making process.

Q.3. In your opinion, what are the effects of this legislation on the ability of companies, States, and Federal regulators to restructure as the energy industry moves toward competition and deregulation? What would be the effect on energy deregulation in general, and on the registered holding companies specifically, if PUHCA is not repealed?

A.3. In my opinion, S. 621 will remove a major barrier to competitive wholesale generation markets and at the same time enhance the authority of the Commission and State regulators to monitor market power abuses and ensure that the industry is not able to use captive rate-payers' money to cross-subsidize entrepreneurial ventures. PUHCA's integration requirement encourages geographically contiguous consolidations of electric generation. While a useful public policy goal when PUHCA was enacted, this structural model for the utility industry is today at odds with the goals of competition. For a competitive marketplace to thrive, public policy should not encourage heavily concentrated generation markets and generation market power by public utilities.

Moreover, a major benefit of competition is to spur innovation and entrepreneurship in the provision of electricity service. Federal law should therefore encourage a broad range of participants in the electricity marketplace and should provide a level playing field for all utility participants. The existing PUHCA inhibits full participation in competitive markets and creates a competitive disadvantage for registered holding companies.

UNITED STATES OF AMERICA 79 ferc 61, 107
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Elizabeth Anne Moler, Chair;
Vicky A. Bailey, James J. Hoecker,
William L. Massey, and Donald F. Santa, Jr.

Enova Corporation and) Docket No. EL97-15-000
Pacific Enterprises)

ORDER ASSERTING JURISDICTION,
DENYING MOTION TO REOPEN DOCKET, AND
DENYING MOTIONS FOR CONSOLIDATION

(Issued April 30, 1997)

On December 6, 1996, Enova Corporation (Enova) and Pacific Enterprises (Pacific) (collectively, Petitioners) filed a petition requesting an order disclaiming jurisdiction over the reorganization of their businesses under a newly-formed holding company. Petitioners maintain that Commission approval under section 203 of the Federal Power Act (FPA) 1/ is not required for the proposed reorganization. However, as discussed more fully below, the Commission has determined that approval under section 203 is required for the disposition of the jurisdictional facilities of Enova's public utility subsidiaries, San Diego Gas & Electric Company (SDG&E), a traditional electric utility, and Enova Energy, a power marketer, encompassed in Petitioners reorganization. 2/

16 U.S.C. 824b (1994).

The Commission will issue subsequent orders to address related filings in Docket No. EL97-21-000 [wherein Southern California Edison Company (SoCal Edison) filed a complaint against SDG&E and Ensource, a Pacific subsidiary, regarding the proposed merger of Enova and Pacific] and in Docket No. EC97-12-000 [wherein SDG&E and Enova Energy filed an application for authorization pursuant to section 203].

I. Background

A. Description of Petitioners

Enova and Pacific are each exempt public utility holding companies under section 3(a)(1) of the Public Utility Holding Company Act (PUHCA) of 1935. 3/

1. Enova

As indicated above, Enova is the parent of SDG&E, a traditional electric utility, and Enova Energy, a power marketer authorized to sell power at market-based rates. 4/ SDG&E owns and operates electric generation, transmission, and distribution facilities, and serves electric customers at retail in San Diego and Orange Counties, California, and natural gas customers at retail in San Diego County California. The creation of Enova was approved by the Commission two years ago, whereupon Enova became the holder of all of SDG&E's common stock and SDG&E's common stockholders became the stockholders of Enova. 5/ In the order approving the stock transfer the Commission indicated that if Enova sought to merge with another holding company the public utilities of those companies would be required to file evidence to rebut the presumption that such a merger would result in an indirect merger of the public utilities, or alternatively for approval. The Commission also specifically noted its authority to issue subsequent orders under section 203(b) of the FPA as needed in the event Enova sought to merge with another holding company.

2. Pacific

Pacific is the parent of, among others, Southern California Gas Company (SoCalGas), a natural gas distribution company. SoCalGas provides gas service to customers in central and southern California, and owns certain qualifying facilities with a total of 1.6 megawatts (MW) of capacity. Pacific's subsidiaries also include various natural gas pipelines, specifically: Pacific Interstate Transmission Company, Pacific Interstate Offshore Pipeline Company, and Pacific Offshore Pipeline Company. Pacific's subsidiary, Pacific Energy, has direct and indirect ownership interests in certain qualifying facilities. Pacific has another subsidiary Ensource, that was a power marketer authorized to sell power at market-based rates.

/ 15 U.S.C. 79c(a)(1) (1994).

/ Enova Energy, Inc., 76 FERC 61,242 (1996).

/ San Diego Gas & Electric Company, Docket No. EC95-6-000, 70 FERC 62,118 (1995).

However, on December 6, 1996, Ensorce filed a notice of cancellation of its market-based rate schedule, which was accepted for filing by order issued January 29, 1997. 6/

B. Planned Merger

The petition states that the two holding companies, Enova and Pacific, would be combined under a newly created holding company, NewCo, that would own all of the stock of the Petitioners and would be owned by the Petitioners stockholders. NewCo Enova Sub, a subsidiary of NewCo would merge into Enova, with Enova as the surviving corporation. NewCo Pacific Sub, also a subsidiary of NewCo would merge into Pacific, with Pacific surviving. All Enova and Pacific common stock would be converted into the right to receive NewCo common stock. Upon consummation of this transaction, the Petitioners would be wholly-owned subsidiaries of NewCo. 7/

The Board of Directors and the highest level officer positions of NewCo initially would be evenly divided between designees of Pacific and Enova, respectively. The petition states that, based on the most recent share holding information available at that time, 52½ percent of NewCo's shares would be converted Pacific shares, and 48½ would be converted Enova shares. Including those shareholders who own both Pacific and Enova stock, however 53½ of NewCo Stock would be owned by former Enova shareholders. The Petitioners SDG&E, and SoCalGas would continue to operate under their existing names.

The petition further explains that the Petitioners have formed a joint venture that would engage in marketing natural gas and electricity. The petition states that the joint venture would not make jurisdictional power sales until after consummation of the merger and after filing a separate application for, and receiving, sales authorization from the Commission.

C. Petitioners Position on Commission Jurisdiction

The Petitioners maintain that Commission approval is not required for mergers occurring at the holding company level. First, the Petitioners state that Commission approval under

Ensorce, 78 FERC 61,064 (1997).

/ The Agreement and Plan of Merger and Reorganization submitted with the petition does not refer to NewCo, but instead refers to the new holding company as Mineral Energy Company. NewCo Enova Sub and NewCo Pacific Sub are referred to as G Mineral Energy Sub and B Mineral Energy Sub, respectively.

section 203 of the FPA is needed only for certain actions taken by public utilities not holding companies. Second, noting the Commission's previous determination that there is a rebuttable presumption that the public utility subsidiaries of merging holding companies also merge (albeit indirectly) the Petitioners assert that the rebuttable presumption has no application here because the planned business reorganization does not involve an indirect merger of public utility subsidiaries. Petitioners state that, with the cancellation of Ensource's rate schedule, Pacific has no public utility subsidiary that could indirectly merge with Enova's public utility subsidiaries, SDG&E and Enova Energy.

The Petitioners also assert that the planned merger does not constitute a disposition of facilities requiring Commission approval under section 203. According to the Petitioners, there will be no transfer of the stock of SDG&E or Enova Energy, nor will the transaction involve any other transfer or reorganization of the jurisdictional facilities of the public utility subsidiaries. Lastly, the Petitioners note that the planned merger will be subject to the review of the California Commission, as well as other federal agencies, and that the Commission's jurisdiction over SDG&E and Enova Energy would be unaffected by the merger. The Petitioners also state that the joint marketing venture developed by the Petitioners would engage in wholesale sales of electricity only to the extent authorized by the Commission after consummation of the merger.

II. Notice of the Petition and Responding Filings

A. Notice, Interventions, Protests, Answer, and Responses

Notice of the petition for declaratory order was published in the Federal Register, with comments, protests, and interventions due on or before January 10, 1997. 8/

Timely, unopposed motions to intervene in this docket were filed by the City of Burbank (Burbank), the City of San Diego (San Diego), 9/ the City of Vernon (Vernon), Imperial Irrigation District (Imperial Irrigation), Kern River (Kern River), K N Marketing Inc. (KN Marketing), the National Rural Electric Cooperative Association and the American Public Power Association, jointly (the Associations), Pacific Gas and Electric Company (PG&E), SoCal Edison, the Southern California Public Power Authority

61 Fed. Reg. 67,041 (1996).

San Diego filed a late motion to intervene in Docket No. EC95-6-000 as part of its timely motion to intervene in Docket No. EL97-15-000.

(Public Power Authority) 10/, and the Southern California Utility Power Pool (SoCal Power Pool). 11/ A notice of intervention was filed by the Public Utilities Commission of the State of California (California Commission). On February 26, 1997, the NutraSweet Kelco Company (Kelco) filed a late motion to intervene.

The motions filed by Burbank, K N Marketing, PG&E, SoCal Power Pool, and Kelco, as well as the notice filed by the California Commission, raised no substantive issues. The motions to intervene filed by the following included protests: Vernon, SoCal Edison, Public Power Authority, Imperial Irrigation, Kern River, and the Associations.

On January 27, 1997, Petitioners filed an answer to the procedural motion filed by San Diego, as well as a procedural motion filed by Imperial Irrigation which is unrelated to the jurisdictional determination addressed in this order and that will be addressed in a subsequent order. On February 28, 1997, SoCal Edison filed a response to an answer the Petitioners filed on February 7, 1997, in the related proceeding in Docket No. EL97 21-000. On April 18, 1997 SoCal Edison filed a motion to admit into this docket a supplemental response to a filing made by Petitioners in Docket No. EL97-21-000. SoCal Edison states that it filed the same responses in Docket No. EL97-21-000.

B. Motions to Consolidate

San Diego moved to reopen Docket No. EC95-6-000 and consolidate Docket No. EC95-6-000 with the instant proceeding. As noted, supra n.5, the Commission there approved the disposition of SDG&E's jurisdictional facilities as part of a corporate reorganization involving the creation of Enova.

Kern River moved to consolidate the instant proceeding with Ensource's rate schedule cancellation proceeding in Docket No.

The Public Power Authority explains that it is a joint powers agency whose members are each engaged in the generation, transmission, and distribution of electric energy, and are customers and competitors of SoCalGas. The members of the Public Power Authority are: the Cities of Anaheim, Azusa, Banning, Burbank, Colton, Glendale, Pasadena, Riverside, and Vernon; the Department of Water and Power of the City of Los Angeles; and the Imperial Irrigation.

The Power Pool states that its members operate municipally-owned electric generation, transmission, and distribution systems that provide electric service in southern California. The members of the Power Pool are the Los Angeles Department of Water and Power, and the cities of Burbank, Glendale, and Pasadena, California.

ER97-703-000, based on its assertion that the proceedings involve similar facts and issues.

C. Positions of the Intervenor

The following descriptions of the positions of the parties do not include arguments raised as to the propriety of approving the proposed transaction or requests for an evidentiary hearing in the event the Commission finds that it has jurisdiction over the transaction. Those positions will be discussed in a later order addressing whether the proposed disposition of jurisdictional facilities is consistent with the public interest.

San Diego asks that the Commission assert jurisdiction over the transaction or "at the least provisional jurisdiction." San Diego also asks the Commission to exercise its authority to issue supplemental orders in Docket No. EC95-6-000 in order to assure jurisdiction over the planned merger. San Diego argues that the Commission should deny the instant petition and apply section 203 in the same manner as it would if NewCo were acquiring SDG&E directly, without Enova as an intervening, middle-tier holding company. San Diego further asks that the Commission require the Petitioners to file, as part of their section 203 application, the competitive screen analysis set forth in the Merger Policy Statement. 12/

Vernon argues that the Commission has jurisdiction over the transaction. Vernon maintains that the Petitioners' argument that the merging holding companies do not have public utility subsidiaries that would indirectly merge as part of the corporate restructuring as a result of Ensorce's cancellation of its market-based rate schedule, amounts to jurisdictional gamesmanship. Vernon argues that this is particularly true here where the Petitioners admittedly are developing a new subsidiary that may well engage in wholesale power sales requiring the same type of authorization as Ensorce filed to cancel. Vernon asserts that Commission review of any future market-based rate authorization request would not be an adequate substitute for review of the public interest implications of this merger.

Vernon also asserts that the Commission made clear its intent to review any future merger of Enova with another holding company in the order approving the creation of Enova. In that order, the Commission advised SDG&E that it must "file under section 203 evidence to rebut the presumption that such a merger would not also result in an indirect merger of the public utility

See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (1996), III FERC Stats. & Regs. 31,044 (1996) (Merger Policy Statement).

subsidiaries, or alternatively, for approval of an indirect merger of the public utilities " 13/ Vernon argues that, as subsidiaries to the same holding company, the merging entities will not exercise independent decision-making authority. Further, Vernon asserts that the Petitioners have not rebutted the presumption that the merger would not preserve competition between the to-be-merged entities. Vernon also states that the ongoing restructuring of the electric industry and the related competitive market power issues cannot be assessed in isolation from the natural gas industry in the same market region.

Imperial Irrigation asserts that the Commission has jurisdiction over the proposed merger. Imperial Irrigation states that the proposed merger involves the disposition of the jurisdictional facilities of SDG&E and Enova Energy, as well as the disposition of Ensorce's jurisdictional facilities through the cancellation of its rate schedule. Imperial Irrigation argues that the Commission should exercise its section 203(b) authority to impose supplemental orders. Imperial Irrigation also states that the cancellation of Ensorce's rate schedule along with the Petitioners' plan to market electric energy through its new joint venture after consummation of the merger demonstrate that Ensorce's rate schedule cancellation was merely an attempt to manipulate Petitioners' jurisdictional status.

SoCal Edison argues that the proposed merger would result in the indirect merger of SDG&E and Enova Energy with Ensorce, as well as the disposition of the jurisdictional facilities of SDG&E and Enova Energy. SoCal Edison states that the cancellation of Ensorce's rate schedule was merely an attempt to avoid Commission jurisdiction over the proposed merger. SoCal further states that nevertheless, the merger entails a de facto indirect merger requiring petitioners to rebut the presumption established in *Illinois Power*, infra. SoCal Edison further argues that Petitioners' reliance on *Missouri Basin*, infra, is misplaced in that *Missouri Basin* stands for the sole proposition that the merger of public utility holdings companies that are not themselves public utilities does not fall within the Commission's jurisdiction.

SoCal Edison argues that the proposed merger entails the disposition of SDG&E's and Enova Energy's jurisdictional facilities. SoCal Edison maintains that the Commission's decision in *Central Vermont*, infra, holds that the substance, not the form, of a transaction governs the Commission's jurisdiction. SoCal Edison also cites *Illinois Power*, infra, as standing for the proposition that the Commission must review mergers before the real corporate independence of public utility subsidiaries and the economic control over jurisdictional facilities is lost.

SoCal Edison asserts that the control of SDG&E and Enova Energy would shift to a new decision maker whose financial and competitive interests would be distinctly different.

The Public Power Authority adopts and incorporates by reference SoCal Edison's protest in this proceeding.

Kern River also argues that the proposed merger requires Commission approval. Kern River asserts that the Petitioners have not rebutted the presumption of indirect merger set forth in Illinois Power, *infra*. Kern River objects to the cancellation of Encourse's rate schedule and asserts that the cancellation appears to be an actual consolidation of power marketing within the ultimate merged entity. Kern River argues that the Petitioners' statement that Pacific's qualifying facilities (QFs) may lose their exempt status as a result of the merger indicates that Pacific's QFs may indirectly merge with Enova's public utilities upon consummation of the merger.

The Associations argue that the Commission has jurisdiction in this case because the proposed merger includes the disposition of jurisdictional facilities, and because section 203 is written broadly enough to encompass any disposition of jurisdictional facilities and any merger or consolidation of such facilities. The Associations also assert that the Commission cannot rely on other agencies or entities to address the effect of the proposed merger on public interest concerns, particularly in light of the Commission's expertise in energy markets. The Associations state that, while other agencies may review the proposed transaction, they will do so under different statutory authority and, therefore, with different purposes.

III. Procedural Matters

A. Interventions, Answer, and Response

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 14/ the timely unopposed motions to intervene and notice of intervention serve to make the following parties in this docket: Burbank, San Diego, Vernon, Imperial Irrigation, Kern River, K N Marketing, the Associations, PG&E, SoCal Edison, the Public Power Authority, the SoCal Power Pool, and the California Commission. Due to the absence of any undue prejudice or delay, the Commission will grant the late, unopposed motion to intervene filed in this docket by Kelco. Pursuant to Rule 213(a)(2), 15/ the Commission will not consider the answer and

18 C.F.R. 385.214 (1996).

18 C.F.R. 385.213(a)(2) (1996).

the response filed by the Petitioners and SoCal Edison, respectively.

B. Motions to Consolidate

San Diego requests that the Commission reopen Docket No. EC95-6-000 in order to exercise its authority to issue supplemental orders under section 203(b), and to consolidate that docket with the instant proceeding. The order in Docket No. EC95-6-000 approved the proposed disposition of SDG&E's jurisdictional facilities to Enova as consistent with the public interest. The order also specifically referenced our authority under section 203(b) to issue supplemental orders, as appropriate. Granting San Diego's request is unnecessary in light of the action taken in this order. Therefore, we will deny the request to reopen Docket No. EC95-6-000 and to consolidate that docket with the instant proceeding. Accordingly, we also will deny San Diego's late motion to intervene in Docket No. EC95-6-000.

Kern River requests that the Commission consolidate the instant proceeding with Ensorce's rate schedule cancellation proceeding in Docket No. ER97-703-000. Kern River states that these dockets should be consolidated because they are integrally related and involve the same set of facts and issues. However, the rate schedule termination has been accepted, and we note that no requests for rehearing of that acceptance were filed. In any event, the Commission's decision in this proceeding does not hinge on Ensorce's status as a power marketer. Therefore, we will deny Kern River's request for consolidation.

IV. Discussion

Based on our analysis of the purposes of section 203 of the FPA, relevant legislative history and case law, and Commission precedent, we conclude that the merger of the Enova and Pacific holding companies will result in a disposition (a transfer of control) of the jurisdictional facilities of SDG&E and Enova Energy, and that, for purposes of section 203, the public utilities SDG&E and Enova Energy will have effectively disposed of jurisdictional facilities. Accordingly, Commission approval of the proposed disposition is required under section 203. In reaching this conclusion, we do not assert jurisdiction over the proposed merger of the holding companies themselves. Rather, we assert jurisdiction over the proposed transfer of control of public utility jurisdictional facilities to ensure that this transfer of control is consistent with the public interest.

A. Statutory Framework and Related Definitions

Section 203 of the FPA, which establishes the Commission's jurisdiction over corporate transactions involving public utility

jurisdictional facilities and public utility securities, is broadly worded and, on its face covers a wide range of corporate activities involving jurisdictional facilities. It also reflects Congress' intent that the Commission be able to ensure that corporate realignments do not adversely affect the maintenance of adequate service or coordination in the public interest of jurisdictional facilities. It reads in pertinent part:

(a) No public utility shall sell, lease, or otherwise dispose of . . . its facilities subject to the jurisdiction of the Commission . . . or by any means whatsoever directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person, or purchase, acquire, or take any security of any other public utility without first having secured an order of the Commission authorizing it to do so. . . . After notice and opportunity for hearing, if the Commission finds that the proposed disposition, consolidation, acquisition, or control will be consistent with the public interest, it shall approve the same.

(b) The Commission may grant any application for an order under this section in whole or in part and upon such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission. The Commission may from time to time for good cause shown make such orders supplemental to any order made under this section as it may find necessary or appropriate. (Emphasis added.)

Thus, section 203 requires Commission authorization before a public utility may

- (1) sell, lease, or otherwise dispose of its jurisdictional facilities,
- (2) directly or indirectly, merge or consolidate any part of its jurisdictional facilities with the jurisdictional facilities of any other person, or
- (3) purchase, acquire, or take any security of any other public utility.

The purpose of section 203 of the FPA was to provide a mechanism for maintaining oversight of the facilities of public utilities, and preventing transfers of control over those facilities that would be detrimental to consumers and/or investors or that would inhibit the Commission's ability to

secure the maintenance of adequate service and the coordination in the public interest of [jurisdictional] facilities. 16/

Neither section 203 nor any other provision of the FPA defines the terms dispose, facilities subject to the jurisdiction of the Commission, merge, consolidate, and control. However, we do not believe these terms should be read narrowly. To do so would result in a jurisdictional void in which certain types of power sales facilities and corporate transactions could escape Commission oversight.

The text of section 203 focuses on jurisdictional "facilities." Over the course of the development of the electric industry, the traditional focus of facilities has been on physical facilities, such as transmission lines and related equipment, for example. However facilities also has been defined to include contracts, accounts, memoranda, papers and other records (often referred to as paper facilities 17/ Without such an interpretation, a large class of entities (power marketers could engage in sales for resale in interstate commerce with no regulation, even if they were affiliated with, or wholly owned by traditional public utilities owning physical facilities since such interstate wholesale sales may not be regulated by the states. As the Commission stated in Citizens Energy Corporation, 18/ in which it determined that a power marketer is a "public utility" under section 201(e) of the FPA by virtue of its wholesale sales transactions and the underlying paper facilities:

Section 201(b) confers jurisdiction over not only facilities (1) for interstate transmission but also - and disjunctively - over facilities (2) for interstate wholesale sales . . . We find [jurisdiction over facilities for interstate wholesale sales] in petitioner's corporate organization, contracts, accounts, memoranda, papers, and other records, in so far as they are utilized in connection with such sales. [19/]

Section 203(b), quoted supra.

Hartford Electric Light Co. (Hartford), 131 F.2d 953, 961 (2d Cir. 1942), cert. denied, 319 U.S. 741 (1943). See also Connecticut Light & Power Co. v. FPC, 324 U.S. 515, 528 n.6 (1945) (discussing Hartford).

35 FERC 61,198 (1986).

Id. at 61,452 (quoting Hartford).

Thus, we conclude that "facilities" under section 203 -- as under other sections of the FPA -- includes the facilities of power marketers (such as Enova Energy) such as wholesale power sales contracts and related accounts and records. 20/

Section 203 also references merge and consolidate. These terms also are not defined in the FPA but are often considered corporate terms of art. When describing corporate amalgamations "merger" is used to denote the vesting of the control of different corporations in a single one by the issue of stock of the others in other words, one corporation absorbs the other and remains in existence while the other is dissolved. On the other hand, a "consolidation" occurs when the consolidating companies dissolve their property and business being transferred to a single company; in other words a new corporation is created and the consolidating corporations are extinguished. 21/

However, we do not believe Congress intended a narrow interpretation of "merge" or "consolidate" Section 203(a) "clearly was not written to describe the strict legal concepts of corporate mergers and consolidations. This language speaks of merger or consolidation of facilities, not of corporate entities. 22/ Additionally section 203 applies to mergers or consolidations that occur directly or indirectly. Thus, even where the public utility corporations or partnerships that own jurisdictional facilities are not themselves dissolved or extinguished, there may be a dissolution of one or more of the entities that own or control those public utilities resulting in an indirect merger of the public utilities jurisdictional facilities. 23/

The Commission also has found that rate schedules are jurisdictional facilities. Ocean State Power, 38 FERC 61,140 at 61,378 (1987).

See Webster's New International Dictionary of the English Language, 1539 (2d Ed. 1948).

Pennsylvania Electric Co. (Pennsylvania Electric), 9 FPC 91, 95 (1950) (emphasis in original; footnote omitted). See also Duke Power Company v. FPC, 401 F.2d 930 at 933 (D.C. Cir. 1968) (Duke).

Also,

[t]ransactions of an acquisitional nature fall easily within the language of the "merge or consolidate" clause which, if limited to dispositive exploits, would largely be a nullity since the first clause of 203(a)

(continued...)

Similarly, we do not believe Congress intended a narrow interpretation of the term "dispose." In common usage, the phrase dispose of means [t]o transfer to the control of someone else, as by selling; to alienate; part with; relinquish; bargain away. 24/ However, section 203 on its face refers not only to traditional means of disposing of facilities (sale, lease) but uses the broad phrase "or otherwise dispose of" (emphasis added). Section 203 also specifically references "control":

After notice and opportunity for hearing, if the Commission finds that the proposed disposition, consolidation, acquisition, or control will be consistent with the public interest, it shall approve the same. (emphasis added.)

Thus, the text of the statute itself supports an interpretation that section 203 was intended to encompass a variety of actions involving jurisdictional facilities, as opposed to an attempt to enumerate every mechanism conceivable in 1935 for transferring control (disposing) of jurisdictional facilities. Additionally the Commission will interpret undefined terms in the statute to preserve its ability to protect consumers from corporate realignments that adversely affect jurisdictional facilities.

B. Legislative History of Section 203

The legislative history of section 203 also supports a broad interpretation of the Commission's jurisdiction over corporate realignments that involve jurisdictional facilities. It indicates that the focus of section 203 is on the disposition of control of jurisdictional facilities, however such disposition might be effected i.e. through sale, lease, merger, consolidation, or acquisition of securities, or otherwise).

Both of the original Senate and House bills (S. 1725 and H.R. 5423) included the forerunner of section 203, which was similarly worded to the provision ultimately enacted:

(...continued)

decrees Commission approval wherever a public utility proposed to "sell, lease, or otherwise dispose of" . . . jurisdictional facilities.

Duke at 933.

See Webster's New International Dictionary of the English Language, 752 (2d Ed. 1948).

(a) No public utility shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its facilities subject to the jurisdiction of the Commission, or by any means whatsoever directly or indirectly merge or consolidate such facilities or any part thereof with those of any other person without first having secured an order of the Commission authorizing it to do so.

(b) No public utility shall hereafter purchase, acquire, take, or hold any security of any other public utility without first having been authorized to do so by the Commission. This subsection shall not prevent the holding of any security lawfully acquired before the enactment of this title.

No changes relevant to the issue here were made to this section during the legislative process. 25/

The Senate and House Reports confirm Congress' intent that section 203 give the Commission sufficient authority over corporate transactions affecting jurisdictional facilities to carry out its jurisdictional responsibilities. In its analysis of section 203(a), the Senate Report states in pertinent part:

This section furnishes an essential check upon the development of the industry along uneconomic lines. It complements [FURCA] by directing the Commission to prevent transfers or consolidations of property which would impair the ability of public utilities to render adequate service or impede, or tend to impede the coordination in the public interest of facilities subject to the jurisdiction of the Commission. [26/]

The House Report on S. 2796 states in pertinent part:

The original versions of the bill included a section 216 which addressed holding company acquisitions. However FPC Commissioner Seavey in his analysis of this version of the bill stated, in pertinent part [Section 216 govern[s] . . . the acquisition of utility securities by holding companies. [This subject is] fully covered by title I of the bill, and [this] section[] can be eliminated." Hearings before the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess. 386 (1935) (House Hearings). See also S. Rep. No. 621, 74th Cong., 1st Sess. 20 (1935). Section 216 subsequently was removed from the bills.

S. Rep. No. 621, 74th Cong., 1st Sess. 50 (1935).

[A]pproval must be secured for the sale, lease, or other disposition [of jurisdictional facilities] . . . and for mergers or consolidations of such facilities . . . Commission approval of an acquisition, consolidation, or control would remove such transaction from the prohibitory provisions of any other law. [27/]

Thus, Congress clearly was concerned about corporate changes that "impede or tend to impede" the coordination of jurisdictional facilities in the public interest. This concern could not reasonably be limited merely to nominal ownership of jurisdictional facilities or corporate form; rather, Congress was concerned with the substantive decision making authority and control over jurisdictional facilities.

C. Case Law

There is no case law that squarely addresses the specific jurisdictional issues before us. However the Court of Appeals for the District of Columbia Circuit addressed the extent of the Commission's jurisdiction under section 203 in *Duke*, supra, and provides useful guidance on the broad focus of section 203. Most pertinent to the case before us, the *Duke* decision supports the conclusion that one of the fundamental prerequisites of section 203 jurisdiction is the presence of jurisdictional facilities. In other words, the Commission's corporate jurisdiction follows facilities subject to the jurisdiction of the Commission.

The *Duke* case involved the acquisition by a public utility of facilities used solely in local distribution of electric energy for retail sale. Specifically, Duke Power Company (*Duke*), a public utility, purchased facilities from Clemson University, [exempt from the FPA under section 201(f)] that had been used for intrastate distribution of electric energy. The Commission determined that the acquisition by *Duke* was a merger or consolidation of facilities with those of another person requiring Commission approval under section 203. The court reversed the Commission's decision.

The issue before the court was whether the [FPA] requires an interstate electric utility to obtain approval by the [FERC] of its acquisition of facilities utilized in the local distribution of electric energy. 28/ In analyzing this issue in light of Congress' delineation between federal and state jurisdiction, the court first concluded that the prohibitions forged by this section are imposed only upon a 'public

H.R. Rep. No. 1318, 74th Cong., 1st Sess. 28 (1935).

Duke at 931.

utility. 29/ Second, the court accept[ed] the Commission's conclusion that the 'merge or consolidate' clause encompasses acquisitions of facilities. 30/ Third, the court determined that even where the other person is not a public utility by virtue of section 201 f) but nevertheless owns or controls what normally would be a jurisdictional facility, section 203 will attach. The court concluded that the phrase 'those of any other person' in section 203(a) must be facilities subject to the jurisdiction of the Commission and that local distribution facilities expressly are not jurisdictional. Because the facilities to be acquired consisted of only non-jurisdictional, local distribution facilities, the court found that the Commission had no section 203 jurisdiction over the acquisition. 31/

While, as noted, the court's analysis does not address the specific jurisdictional issues presented in this proceeding, we believe our analysis is entirely consistent with the Duke court's fundamental holding that section 203 jurisdiction is triggered only where jurisdictional facilities are involved.

D. Commission Precedent

1. Disposition of Facilities

The Commission has interpreted its section 203 jurisdiction in a number of cases as the industry has evolved over the last decade, and our analysis of the issues presented by the Enova/Pacific merger is consistent with, and builds upon, the precedent established.

The seminal Commission decision interpreting the disposition clause of section 203(a) is *Central Vermont*. 32/ In *Central Vermont*, the Commission determined that the transfer of all of a public utility's stock is a transfer of ownership and control of the utility's jurisdictional facilities and that such transfer constitutes a disposition of jurisdictional facilities requiring Commission approval under section 203. The Commission stated:

[T]he transfer of ownership and control of Central Vermont's jurisdictional facilities, from Central

Id.

Id.

Id.

Central Vermont Public Service Corporation (Central Vermont), 39 FERC 61,295 (1987).

Vermont

s existing shareholders to the newly created holding company, constitutes a disposition of jurisdictional facilities requiring prior Commission approval under section 203. After the reorganization the jurisdictional facilities of the public utility will be controlled through the parent s ownership of the utility s common stock by virtue of the parent

s ability to name Central Vermont

s board of directors.

Although the current stockholders of the public utility will own stock in the holding company after the reorganization is completed, they will no longer have a proprietary interest in, or direct control over the jurisdictional facilities. The substance of the transaction, therefore, is a "disposition" of facilities via the transfer of all direct control.

To the extent that utility revenues are used to finance non-utility operations, the cost of utility service may be increased. If the parent makes unwise investment decisions the reliability of service of jurisdictional facilities could be impaired. This aspect of the holding company/operation utility relationship was a concern to those who enacted Title II of the Public Utility Act. [

33/]

In Central Illinois, 34/ the Commission explained that its assertion of jurisdiction in Central Vermont was not based solely on the transfer of stock, but rather that the Commission's concern lies in the transfer of control of public utilities and, thereby, control over the jurisdictional facilities of those public utilities. After considering the legislative history of section 203, the Commission found that "Congress intent was to ensure that the Commission maintain oversight over any transfer of jurisdictional utility property" 35/

Central Vermont at 61,960.

Central Illinois Public Service Company (Central Illinois), 42 FERC 61,073 (1988).

Central Illinois at 61,328 (emphasis in original). See also, Savannah Electric & Power Co., 42 FERC 61,240 (1988), which involved the transfer of all of a public utility's stock to a registered public utility holding company. The Commission asserted jurisdiction, relying on the rationales set forth in Central Vermont and Central Illinois. The Commission also analyzed the application of section 318 of the FPA to the transaction and concluded that section 318 did not apply. Section 318 provides that the SEC s jurisdiction preempts the Commission s jurisdiction under certain circumstances. The

(continued...)

The Commission also has discussed certain elements of control in cases outside the context of section 203. The Commission has linked "decision-making" and dominion and control to its determination of "control" over facilities in determining whether an entity is a "public utility." The Commission also has said that the reference to "operates jurisdictional facilities" in the definition of public utility in section 201(e) of the FPA refers to the person who has control and decision-making authority concerning the operation of facilities." 36/ In sale/lease-back cases, the Commission has disclaimed jurisdiction over entities with a mere fiduciary interest in facilities where the entity holding the fiduciary interest could not exert control over the entity responsible for operating the facilities. 37/ Also, we note that the definition of control that has been in the Commission's accounting regulations since 1937 is:

Control (including the terms controlling, controlled by and under common control with) means the possession,

(...continued)

Commission found that under section 203, the Commission had jurisdiction over the disposition of facilities (via a transfer of stock) of the public utility, while the SEC had jurisdiction to approve or disapprove the holding company's acquisition of the public utility's stock. The Commission further explained:

In finding that section 318 does not preclude our assertion of jurisdiction, we wish to again emphasize that it is not our intent to undertake regulation of every stock transfer made by public utility shareholders. Our concern is solely with transfers of control of public utilities and thereby the jurisdictional facilities of those public utilities. Further our assertion of jurisdiction is solely to fulfill our obligations under section 203 of the FPA in a manner that is complementary to the SEC's jurisdiction over reorganization transactions.

Savannah at 61,779 (emphasis in original.) See also, Central Illinois, 42 FERC at 61,328-329.

See, e.g., Bechtel Power Corp., 60 FERC 61,156 (1992).

See, e.g., Allegheny Electric Cooperative, Inc., 47 FERC 61,015 (1989); Baltimore Refuse Energy Systems Co., 40 FERC 61,366 (1987); Pacific Power & Light Co., 3 FERC 61,119 (1978).

directly or indirectly, of the power to direct or cause the direction of the management and policies of a company whether such power is exercised through one or more intermediary companies, or alone or in conjunction with, or pursuant to an agreement, and whether such power is established through a majority or minority ownership or voting of securities, common directors officers or stockholders, voting trusts, holding trusts, associated companies, contract or any other direct or indirect means. [38/]

2. Mergers and Consolidations

In *Illinois Power*, 39/ the Commission reviewed and clarified its jurisdiction under section 203 in instances where holding companies merge, and determined that "most mergers of public utility holding companies will simultaneously involve an indirect merger of the public utility subsidiaries of such holding companies." 40/ The Commission described the three-step process some utilities were following to reorganize, and explained how section 203 jurisdiction applied at each step.

In step one, a public utility transfers ownership of all of its stock to a newly-formed holding company.

Following *Central Vermont*, the Commission reiterated that such a transfer constitutes a transfer of the ownership and control of the utility's jurisdictional facilities and, therefore, is a disposition of facilities subject to section 203 approval.

In step two, the public utility holding company merges with another public utility holding company.

The Commission stated that it does not have jurisdiction over the merger of holding companies unless the holding companies own or operate jurisdictional facilities. However, the Commission adopted a rebuttable presumption that when public utility holding companies merge, their public utility subsidiaries likely retain no real corporate independence that decision-making for the public utilities would typically rest with the new holding

This definition was adopted in Order No. 42, 1 Fed. Reg. 691 (1936), codified and reissued in Order No. 141, 12 Fed. Reg. 8461 (1948), and may be found at 18 C.F.R. Part 101, Definitions 5.B. (1996).

Illinois Power Company (Illinois Power), 67 FERC 61,136 (1994).

Id. at 61,352-53.

company, and that, therefore, an indirect merger of the public utilities occurs requiring section 203 authorization. 41/

In step three, the public utility subsidiaries of the merged holding companies formally merge and section 203 approval is required.

In discussing the adoption of a rebuttable presumption of indirect mergers, the Commission stated that its decision was informed by *Copperweld*, 42/ where the Court held that section 1 of the Sherman Act, which outlaws conspiracies or combinations in restraint of trade, regards as one company a parent and subsidiary that maintain separate operations. The Commission offered the court a explanation, which strongly supports a conclusion that this Commission must be able to look beyond corporate form in determining whether a public utility is effectively disposing of merging, or consolidating its jurisdictional facilities:

A parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousness but one. . . [in reality a parent and a wholly owned subsidiary always have a "unity of purpose or a common design" . . . whether or not the parent keeps a tight rein over the subsidiary the parent may assert full control at any moment if the

Illinois Power at 61,354. In reaching this conclusion, the Commission departed from its decision in a prior case, *Missouri Basin Municipal Power Agency* 53 FERC 61,368 (1990), reh'g denied, 55 FERC 61,464 (1991), in which it had not asserted jurisdiction based on similar facts. It affirmed only that part of *Missouri Basin* that held that the Commission does not have jurisdiction over the merger of holding companies.

Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984). See also *Century Oil Tool, Inc. v. Production Specialties, Inc.*, 737 F.2d 1316, 1317 (5th Cir. 1984), where the Court stated:

Given *Copperweld*, we see no relevant difference between a corporation wholly owned by another corporation, two corporations wholly owned by a third corporation or two corporations wholly owned by three persons who together manage all affairs of the two corporations. A contract between them does not join formally distinct economic units. In reality, they have always had a unity of purpose or a common design.

subsidiary fails to act in the parent's best interest.
 467 U.S. at 771-72 (emphasis in original; footnote
 deleted). {43/}

Similarly, while section 203 is applicable only to actions taken by public utilities, we will look beyond the corporate form of a transaction, and regard a parent and subsidiary as one company, 44/ in instances where the control over a public utility and its jurisdictional facilities is transferred from one corporate entity to another. Further, the fact that the Commission does not have jurisdiction over every aspect of a proposed corporate transaction does not mean that the Commission has to ignore those aspects of the transaction that effect a change in control over a public utility's jurisdictional facilities.

E. Conclusion

In this proceeding, two public utility holding companies (Enova and Pacific) propose to merge; one of the holding companies is the parent of two public utilities (SDG&E and Enova Energy) 45/ There is no dispute that Commission jurisdictional facilities are involved in the proposed transaction. SDG&E owns both physical and "paper" facilities used for the transmission and sale for resale of electric energy in interstate commerce, and Enova Energy owns "paper" facilities that permit it to market power at wholesale in interstate commerce. Therefore, the remaining question is whether SDG&E and/or Enova Energy will have effectively disposed of and/or merged or consolidated jurisdictional facilities for purposes of section 203. If so, Commission authorization under section 203 is required.

While the FPA does not specifically delineate the meaning of the disposition or "merger or consolidation" of jurisdictional facilities under section 203, it is clear under the language of section 203 itself as well as the Duke case that the Commission's jurisdiction under section 203 attaches to jurisdictional facilities and that Congress intended that the Commission be able

Illinois Power at 61,354.

See San Diego Gas & Electric Co., 38 FERC 61,241 at 61,778 (1987) (agency may disregard corporate form; corporations may be regarded as one entity for one purpose even though they are legitimately distinct for others; inquiry is whether statutory purposes would be frustrated by corporate form).

The jurisdictional determinations made in this order preclude the need to address arguments raised regarding Ensource's rate schedule cancellation as an element of the proposed corporate realignment, or related issues, in connection with this proceeding.

to secure the maintenance of adequate service and the coordination in the public interest of those facilities. Additionally, the references on the face of the statute [section 203(a) to or otherwise dispose and the proposed disposition, consolidation, acquisition, or control (emphases added) reflect an intent to cast a broad net over various types of transactions so that public utilities and their affiliates cannot use form over substance to avoid regulatory oversight of corporate realignments affecting jurisdictional facilities, paper or otherwise. Similarly, the merge or consolidate clause of section 203 applies to public utilities that "by any means whatsoever, directly or indirectly" merge or consolidate their facilities (emphasis added) and reflects an intent to capture a broad scope of activities and means of accomplishing those activities.

Further, while section 203 applies to a public utility that disposes of or merges or consolidates its jurisdictional facilities as explained above, the Commission may disregard corporate form and regard a parent and its subsidiary as a unit in order to determine whether statutory mandates would be frustrated by the proposed transaction. While the Commission does not have jurisdiction over the merger of holding companies that are not themselves public utilities, section 203 was intended to preserve the Commission's oversight of corporate realignments that may impact the coordination in the public interest of jurisdictional facilities, no matter how accomplished.

On the facts of this case, as discussed further below, we conclude that the proposed merger of Enova and Pacific will result in a transfer of control of the jurisdictional facilities of Enova's two public utility subsidiaries, SDG&E and Enova Energy. Therefore, we do not need to reach the question of whether the proposed merger also results in a direct or indirect merger or consolidation of the SDG&E or Enova Energy jurisdictional facilities with those of any other person. We further conclude that for purposes of section 203, Enova and its public utility subsidiaries act as one company and are effectively disposing of jurisdictional facilities via a transfer of control over those facilities to NewCo. To hold otherwise would elevate form over substance.

In their petition for a declaratory order, the Petitioners rely on Missouri Basin as support for their argument that the Commission may not review mergers between holding companies. The petitioners also argue that the Commission may not review mergers involving public utilities unless there exists the type of indirect merger described in Illinois Power. Lastly the petitioners argue that a disposition of facilities does not occur in their proposed transaction because, the petitioners say, the stock of the public utilities will not be transferred.

There are several fundamental flaws in these arguments. First, as stated above, the Commission agrees that it does not have jurisdiction over mergers of holding companies that are not also public utilities. Our assertion of jurisdiction is not over the merger of the holding companies; rather, our concern is over the control of the jurisdictional facilities of the public utilities in the holding company system. Second, the Missouri Basin and Illinois Power cases did not address the situation here and cannot in any event, be interpreted as holding that the Illinois Power scenario is the only type of indirect merger over which the Commission has section 203 jurisdiction. Third, since all the stock of SDG&E and Enova Energy is owned by Enova, and since all of Enova's stock will be transferred to the new holding company, the substance of the transaction will be a disposition of control of the public utilities' jurisdictional facilities to the new holding company. Even though Enova will continue to own the public utilities' stock after the transfer, control over the public utilities (and their jurisdictional facilities) will be exercised by NewCo and its shareholders under a divergently different corporate form with economic goals which reflect the corporate purposes of the newly-created holding company. 46/ As such, there is indeed a disposition of jurisdictional facilities of SDG&E and Enova Energy.

The petitioners cite Missouri Basin and Duke to support their argument that section 203 only gives the Commission jurisdiction over actions taken by public utilities. They suggest that after the initial transfer of the public utility's

Petitioners make two related arguments in support of their position that their merger will not result in any change in control over SDG&E's and Enova Energy's jurisdictional facilities. First, they note that the stock of Enova is widely dispersed among members of the public and the same will be true of NewCo's stock. Second, they argue that there will be no change in control since a majority of NewCo's shares, including those shareholders that currently own both Pacific and Enova stock, will be owned by former Enova shareholders. This is a variation of an argument rejected in Central Vermont.

In Central Vermont, the Commission found that even though the current shareholders of the public utility would own the holding company's stock after the reorganization was completed, they would no longer have direct control over the public utility's jurisdictional facilities. Here, Enova's current shareholders will not be able to exercise the control over SDG&E and Enova Energy, and their jurisdictional facilities, as they are able to exercise today. This does not change because NewCo's stock will be widely dispersed, or because a majority of its stock will be owned by persons that currently own Enova shares.

stock to a holding company, the public utility loses any ability to exert control over its jurisdictional facilities and therefore cannot dispose of its jurisdictional facilities in subsequent corporate transactions because control over its jurisdictional facilities lies solely with the holding company. Carried to its logical conclusion this argument would lead to the result that if a stand-alone public utility created a holding company above it the Commission would have jurisdiction due to a change in control of the public utility's jurisdictional facilities, but if the holding company then immediately sold 100% of its stock to another party (who would then be able to control the first tier holding company and thus the public utility) the Commission would not have jurisdiction even though the control over the public utility's facilities is being transferred in both transactions. In short, form would be elevated over substance.

As discussed above, the Commission may regard corporations as one entity in order to ensure that statutory purposes are not frustrated by corporate form. Therefore, for purposes of ensuring that the transfer of control of SDG&E and Enova Energy is consistent with the public interest Enova and its public utility subsidiaries may properly be regarded as one entity.

In Central Vermont, the Commission discussed at some length the concern that the transfer of ownership and control of jurisdictional facilities could "present potential for abuses adverse to the public interest" 47/. The Commission has expressed concern over the potential effect such a corporate structure might have on reliability of service or use of operating utility funds for corporate activities unrelated to utility service 48/ as well as abuses adverse to the public interest which could result from the ever-increasing reorganizations involving jurisdictional public utilities." 49/

The Commission has a broad public interest mandate in section 201 a of the FPA to oversee the operational aspects of the electric power industry including issues involving bulk power supply and transmission access. The industry currently is undergoing a fundamental restructuring which entails wholesale competitive power markets and, increasingly, competitive retail power markets. As the competitive energy markets evolve, the Commission has a public interest responsibility to be vigilant with respect to the corporate realignment of the jurisdictional facilities of both traditional public utilities and the public utility power marketers that are playing an increasingly larger

Central Vermont at 61,960.

Id.

Central Illinois at 61,328.

role in bulk power supply. Our interpretation of section 203 is clearly consistent with the Congress' intent in enacting the provision, and the jurisdictional responsibilities given to the Commission.

The Commission does not intend to affect the actions of public utility holding companies unnecessarily; nevertheless, the Commission would be remiss in upholding its statutory mandate if it allowed control over jurisdictional facilities to be removed from its oversight merely by how the transaction is structured. Accordingly, the petitioners request for a declaratory order disclaiming jurisdiction over the merger of Enova and Pacific will be denied because the merger encompasses the disposition of the jurisdictional facilities of SDG&E and Enova Energy via a transfer of control.

F. Guidance for Future Cases

We understand that industry participants, in this time of restructuring, need as much certainty as possible concerning the circumstances in which we have jurisdiction under section 203, as well as a better understanding of how quickly the Commission will be able to process section 203 filings. We believe that the discussion above, applicable to the instant proceeding as well as to our companion orders in the NorAm 50 and Morgan Stanley 51 proceedings issued today, answers in large part the first question by providing the framework which we will use to analyze whether a proposed corporate realignment involves a disposition and/or direct or indirect merger of jurisdictional facilities.

We acknowledge that we cannot definitively identify every combination of entities or disposition of assets that may trigger section 203 jurisdiction since we cannot anticipate every type of restructuring that might occur in response to rapidly evolving competitive pressures. However, it should be clear that our concern is with changes in control, including direct or indirect mergers, that affect jurisdictional facilities (whether physical or "paper" facilities). We must maintain flexibility in responding to industry restructuring if we are to discharge our statutory responsibility "to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission."

Order Asserting Jurisdiction, NorAm Energy Services, Inc., Docket No. EL97-25-000.

Order Authorizing Dispositions of Jurisdictional Facilities and Denying Request for Disclaimer of Jurisdiction, Morgan Stanley Capital Group, Docket Nos. EC97-23-000 and EL97-30-000; Chi Power Marketing, Docket No. EC97-26-000.

In asserting jurisdiction over new types of corporate realignments that involve jurisdictional facilities, we will commit, within the constraints of our resources, to make every effort to efficiently process those section 203 filings that come before us. It is clear that many of these transactions may involve few public utility assets and may have little or no impact in the pertinent geographic and product markets. In these cases we intend to be flexible as to what information must be filed, to provide shortened comment periods on the filings, and to issue orders expeditiously.

We take this opportunity to comment briefly on the information we expect to see from applicants and the procedures we intend to follow, in those section 203 filings that, for example, do not involve a merger or consolidation of jurisdictional facilities or do not otherwise raise market power concerns. As reflected in the Merger Policy Statement, the mergers of greatest potential concern to the Commission are mergers between vertically integrated electric utilities that own generation and/or transmission facilities. Thus for example review of a disposition of a marketer's jurisdictional facilities alone may not necessarily raise complex issues and, therefore, may be amenable to expeditious action by the Commission. Even if a power marketer owns generation facilities, it may be that its facilities are geographically dispersed such that their transfer to another power marketer would not raise complicated issues.

Similarly, cases may arise, such as Morgan Stanley, in which the disposition of a marketer's jurisdictional facilities occurs within the context of a merger of entities engaged in businesses unrelated to our jurisdictional concerns under the FPA. There again, expeditious review and action by the Commission may be anticipated. On the other hand, additional review in various degrees may be required where, for example, a marketer is merging with another power marketer or with an entity with control over fuel resources or transportation facilities necessary for electric generation, thus raising concerns about the potential to create barriers to entry.

We believe that the Morgan Stanley proceeding, which we approved today, provides useful guidance on these types of disposition applications. Morgan Stanley involves a proposed merger of two Wall Street financial firms one of which owns a public utility power marketer. We found that a disposition of the jurisdictional facilities of that public utility via a change in control will take place as part of the merger and we authorized the disposition. With respect to the information necessary to support the proposed disposition application, the applicants in Morgan Stanley addressed the effect the transaction would have on competition, on rates, and on regulation. They explained why an Appendix A competitive analysis was not needed in the circumstances presented but nevertheless proceeded to

explain why the transaction would not have an adverse effect on competition. This is an acceptable approach in circumstances that do not involve a merger or consolidation or other actions that would result in the aggregation of generation and/or transmission market power. 52/

However, the fact that an Appendix A analysis was not needed in Morgan Stanley does not mean it may not be necessary in other applications involving dispositions of facilities that present different facts. Our focus will be on whether the transaction enhances the ability of the affected public utility or utilities to exercise market power in relevant geographic and product markets. The information applicants submit to support a disposition of facilities must be adequate for us to analyze the effect on competition, if any.

Similarly, applicants must be prepared to address the effect on rates and regulation. As in Morgan Stanley where the only affected public utility was a power marketer authorized to sell at market-based rates and engaged only in wholesale power sales in interstate commerce the information supplied can be concise. However, the type of information necessary to address these factors may vary depending on the circumstances.

Finally, we will make every effort to expedite the processing of disposition applications. While we normally provide a 60-day comment period on section 203 applications, a shorter notice period might be appropriate in cases of the type in Morgan Stanley or in unusual circumstances. In the Merger Policy Statement the Commission stated its intent to make a reasonable effort to issue an initial order on a completed application 60-90 days after the comment period closes. 53/ If the application does not raise significant concerns the Commission may be able to take action on an even more expedited basis. Any request for expedited action must be fully supported and should discuss how long it took from the time the contract was signed until the date of filing with the Commission.

The Commission orders:

(A) The late, unopposed motion to intervene in this docket filed by NutraSweet Kelco Company is hereby granted, as discussed in the body of this order.

(B) Vernon's motion to consolidate Docket No. ER97-703-000 with this docket is hereby denied, as discussed in the body of this order.

Merger Policy Statement at 30,113 and 30,136.

Merger Policy Statement at 30,127.

(C) San Diego's motion to reopen Docket No. EC95-6-000 and to consolidate that docket with this docket is hereby denied, as discussed in the body of this order.

(D) San Diego's motion for late intervention in Docket No. EC95-6-000 is hereby denied, as discussed in the body of this order.

(E) The answer filed by the Petitioners and the responses filed by SoCal Edison are rejected, as discussed in the body of this order.

(F) The Petitioners' petition for declaratory order disclaiming jurisdiction is denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Lois D. Cashell,
Secretary.

UNITED STATES OF AMERICA 79 ferc 61, 108
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Elizabeth Anne Moler, Chair;
Vicky A. Bailey, James J. Hoecker,
William L. Massey, and Donald F. Santa, Jr.

NorAm Energy Services, Inc.) Docket No. EL97-25-000

ORDER ASSERTING JURISDICTION

(Issued April 30, 1997)

Introduction

By order issued on February 5, 1997, 1/ the Commission initiated a jurisdictional inquiry concerning a proposed merger involving NorAm Energy Services, Inc. (NorAm), a public utility under the Federal Power Act (FPA). As discussed below, we find that the proposed merger involves the disposition of NorAm's jurisdictional facilities via a change of control of those facilities and, thus, falls within the jurisdiction of the Commission under section 203 of the FPA. 2/

- 1/ NorAm Energy Services, Inc., 78 FERC 61,111 (1997) (February 5 Order).
- 2/ Section 203 provides in pertinent part:

(a) No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, or any part thereof of a value in excess of \$50,000, or by any means whatsoever directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person, or purchase, acquire, or take any security of any other public utility without first having secured an order of the Commission authorizing it to do so. . . . After notice and opportunity for hearing, if the Commission finds that the proposed disposition, consolidation, acquisition, or control will be consistent with the public interest, it shall approve the same.

(b) The Commission may grant any application for an order under this section in whole or
(continued...)

Background

A. The Commission's Jurisdictional Inquiry

On September 30, 1996, NorAm filed a notice of change in status, as required by the order of the Commission accepting its market-based rate schedule, 3/ to inform the Commission of the proposed merger of NorAm's parent company NorAm Energy, with:

1 Houston Industries, Inc (Houston Industries) an exempt public utility holding company; and (2 Houston Industries subsidiary Houston Lighting & Power Company (HL&P) an electric utility located in the Electric Reliability Council of Texas (ERCOT) engaged in the generation, transmission, distribution, and sale of electric energy within the State of Texas.

Under the proposed merger, Houston Industries would be merged into HL&P; HL&P, renamed Houston Industries, Inc. (New Houston Industries) would be the surviving corporation. NorAm Energy would then be merged into HI Merger Inc. (HI Merger) a wholly-owned subsidiary of New Houston Industries; HI Merger, renamed NorAm Energy Corporation (New NorAm Energy), would be the surviving corporation. As a result New Houston Industries would be the parent company with HL&P operating as a division of New Houston Industries, and Houston Industries Energy, Inc. (HI Energy) 4/ and New NorAm Energy as subsidiaries. NorAm thus would become a second-tier, wholly-owned subsidiary of New

2/ (...continued)

in part and upon such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission. The Commission may from time to time for good cause shown make such orders supplemental to any order made under this section as it may find necessary or appropriate.

16 U.S.C. 824b(a) (1994).

- 3/ See NorAm Energy Services, Inc., Docket No. ER94-1247-000, Letter Order (issued July 25, 1996) (unpublished).
- 4/ HI Energy, a subsidiary of Houston Industries, owns interests in foreign utilities, exempt wholesale generators and a qualifying facility.

Houston Industries and a wholly-owned subsidiary of New NorAm Energy. 5/

In the February 5 Order, the Commission stated:

NorAm is a public utility marketer. Its jurisdictional facilities include its market-based power sales tariff under which it is authorized to engage in sales of energy at wholesale in interstate commerce and its contracts for sales for resale in interstate commerce. Pre-merger the public utility NorAm, and its jurisdictional facilities, are controlled by its parent, NorAm Energy. Post-merger it appears that the new parent holding company, New Houston Industries, will control the jurisdictional facilities of the public utility NorAm through its ownership of NorAm Energy. Thus, there is an issue of whether Commission authorization under section 203 is required for this transaction.

Without deciding the issue, we note that in Central Vermont, we indicated that, in reviewing corporate transactions and relationships, we would focus on the substance of transactions and relationships rather than their form. Moreover section 203 was intended to be prophylactic in operation. Under section 203 the enumerated activities can only be undertaken after the applicant has secured an order of the Commission authorizing it to do so. Although NorAm Energy has not sought a ruling on this issue, we believe the jurisdictional question must be resolved prior to consummation of the transaction.

78 FERC at 61,422-23 (footnotes omitted). The February 5 Order directed NorAm to file a response and provided for interventions or protests.

- 5/ NorAm's notice of change in status also stated that the parties were considering alternative merger plans which would be used under certain circumstances to effect the merger of the companies. However under each alternative merger plan, NorAm Energy would become a direct or indirect wholly-owned subsidiary of the Houston Industries corporate organization.

B. Pleadings

On March 7, 1997, NorAm filed a response. It argues that the Commission lacks jurisdiction over the proposed merger. 6/

Timely notices of intervention raising no substantive issues were filed by the Mississippi Public Service Commission (Mississippi Commission), and the Public Utility Commission of Texas (Texas Commission). A timely motion to intervene raising no substantive issues was filed by the Railroad Commission of Texas.

On March 26, 1997, Electric Clearinghouse, Inc. (Clearinghouse) filed a motion to intervene out of time, raising no substantive issues. 7/

Discussion

A. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. 385.214 (1996), the notices of intervention and timely, unopposed motion to intervene serve to make the Mississippi Commission, the Texas Commission and the Railroad Commission of Texas parties to this proceeding. Further, due to the early stage of this proceeding and the absence of any undue prejudice or delay, we will grant the late, unopposed motion to intervene of Clearinghouse.

B. NorAm's Response

NorAm contends that the requirements for Commission approval in section 203 apply only to actions by a public utility as defined in the FPA. 8/ It argues that none of companies merging

6/ On March 27, 1997, in Docket No. EC97-24-000, NorAm filed an application for authorization for the proposed reorganization under section 203. In the application, NorAm states that if the Commission concludes that it lacks jurisdiction over the proposed reorganization, then the section 203 application should be deemed withdrawn.

7/ Clearinghouse states that the delay in filing its motion to intervene was due to an administrative oversight.

8/ Section 201(e) of the FPA defines a public utility as any person who owns or operates facilities subject to the jurisdiction of the Commission under [Part II of the FPA] (other than facilities subject to such jurisdiction solely by reason of section 210, 211, or 212. 16 U.S.C. 824(e)

(continued...)

as part of the proposed transaction is a public utility. It states that EL&P is not a public utility under the FPA. It further states that EL&P's parent, Houston Industries, is an exempt holding company and is not a public utility.

NorAm further argues that it is the only affiliate of any party associated with the NorAm Energy-Houston Industries merger that arguably is a public utility. However, NorAm distinguishes itself from a traditional public utility, stating: Unlike traditional public utilities, [NorAm] does not own any generation, transmission, distribution or other physical utility facilities. Indeed, neither [NorAm Energy] nor any of its affiliates own any generation or electric transmission facilities. 9/ Further NorAm asserts that (1) it will remain a wholly separate subsidiary of NorAm Energy throughout and after the transaction; (2) it will not sell, lease or otherwise dispose of any part of its jurisdictional facilities (which it states consists solely of NorAm's books, records and contracts) and (3) it will not by any means whatsoever directly or indirectly merge or consolidate its jurisdictional facilities with any facilities jurisdictional or non-jurisdictional, of any other company involved in the transaction. Thus, NorAm argues that it is not taking any action that requires an order under section 203.

NorAm contends that state regulation and the Commission's regulation of the various NorAm Energy and Houston Industries companies will be unaffected by the merger. It asserts that it is a special type of public utility that has no historical utility facilities and must operate under a comprehensive code of conduct to maintain its status as a power marketer. It contends that these factors distinguish its situation from transactions that previously have come before the Commission, as well as those that are likely to come before the Commission in the future. 10/ It further contends that the Commission has continuing

8/ (...continued)
(1994).

9/ NorAm Response, pp. 3-4.

10/ It contends that the Commission made no similar jurisdictional inquiry with respect to the transaction involving El Paso Energy Corp. and Tenneco Energy, which it contends involved a merger with Commission-authorized power marketers on both sides.

It is not the Commission's responsibility to solicit any required authorization. That responsibility lies with the public utility.

jurisdiction over its power marketing authorization before and after the merger.

NorAm also argues that the Commission lacks jurisdiction over the merger itself, because none of the three jurisdictional events described in section 203 occurs when NorAm Energy and Houston Industries merge. First, NorAm states that it is not purchasing the stock of another public utility. Second, it states that it is not taking action of any kind in the transaction. 11/ Therefore, it concludes that Central Vermont 12/ does not apply. It argues that NorAm Energy's merging partner also is not a public utility, and that the Commission has held that it does not have jurisdiction over the merger of two holding companies that are not themselves public utilities. 13/ It argues that Missouri Basin and Illinois Power stand for the proposition that the merger of a public utility's parent is not a disposition of the utility's facilities giving rise to Commission jurisdiction under section 203.

NorAm further argues that there is another reason why the merger will not result in any change in control over its facilities which could be equated to a disposition of those facilities. It contends that the prohibitions and standards of conduct that have been prescribed by the Commission under its power marketer program, as well as NorAm's rate schedule, ensure that HL&P may not assume control over NorAm's facilities. Moreover, the Commission has ongoing jurisdiction over NorAm to ensure that these prohibitions and standards are observed and that jurisdictional facilities are not disposed of in this manner. NorAm also argues that the circumstances present in Central Vermont and Central Illinois Public Service Co. 42 FERC 61,073 (1988) (Central Illinois) both of which were cited in the February 5 Order are not present in the instant case. It further argues that Central Vermont and Central Illinois were not appealed and, thus, the Commission's determinations in those cases were never subjected to judicial review.

- 11/ NorAm maintains that: it is not disposing of its facilities in any ordinary sense of that term; it is not transferring its stock to a newly created holding company; and NorAm Energy, not NorAm, is merging with another company.
- 12/ Central Vermont Public Service Corp., 39 FERC 61,295 (1987).
- 13/ NorAm Response, p. 8 (citing Missouri Basin Municipal Power Agency v. Midwest Energy Co., 53 FERC 61,368 (1990), reh'g denied, 55 FERC 61,464 (1991) (Missouri Basin); Illinois Power Co., 67 FERC 61,136 (1994) (Illinois Power)).

C. The Commission's Determination

As we explain below, we find that the proposed merger between NorAm Energy and Houston Industries will effect a disposition of NorAm's jurisdictional facilities via a change in control of such facilities and that this requires Commission authorization under section 203. In reaching this determination, we have reviewed the statutory language of section 203, relevant legislative history, case law and Commission precedent, all of which are discussed in another case being issued concurrently, and which discussion we incorporate by reference herein. 14/ Below we address only those arguments by NorAm that are not already fully addressed in the accompanying case or that pertain to the specific facts of the NorAm Energy-Houston Industries transaction. We find that NorAm's arguments that the Commission lacks jurisdiction over the proposed transaction are not persuasive.

NorAm's argument that we lack jurisdiction over the merger because the merging entities, NorAm Energy and Houston Industries, are not public utilities is not on point. As we state in the Enova-Pacific case, 15/ our jurisdiction does not attach to the two holding companies that are merging. Rather, similar to Enova-Pacific, here our jurisdiction attaches to the disposition of NorAm's jurisdictional facilities only through a transfer of control of those facilities. By virtue of the reorganization, NorAm will go from being a subsidiary of NorAm Energy to being a subsidiary of New NorAm Energy and New Houston Industries, thus transferring control over NorAm from NorAm Energy to New NorAm Energy and New Houston Industries.

NorAm argues that because it is a power marketer, it should be treated differently from other public utilities for purposes of analyzing section 203 jurisdiction. Of course, the statute makes no such distinction and we are not aware of any judicial or Commission precedent to support that proposition. Section 203 applies to dispositions of any jurisdictional facilities of a public utility. The fact that NorAm is not a traditional public utility, but owns only paper facilities rather than physical utility facilities (such as transmission lines) does not mean that its facilities are any less subject to the Commission's jurisdiction than if they were physical utility facilities. Those paper facilities, which include wholesale power sales contracts and books and records by which NorAm engages in

14/ See Enova Corporation and Pacific Enterprises, 79 FERC _____ (1997) (Enova-Pacific) (asserting jurisdiction over a proposed disposition of jurisdictional facilities that presents facts similar to the instant case).

15/ 79 FERC at _____, slip op. at 22.

jurisdictional sales at wholesale in interstate commerce, are jurisdictional facilities under section 201 of the FPA, and therefore are also jurisdictional facilities under section 203. As in Enova-Pacific we find that the disposition of such facilities is subject to our jurisdiction under section 203. 16/

We also reject NorAm's arguments that it is the holding companies and not NorAm the public utility, that are taking any of the actions described in section 203. In Enova-Pacific, we determine that by virtue of the merger between the two holding companies, there will be a transfer of control of the jurisdictional facilities of Enova's two public utility subsidiaries 17/ For purposes of section 203, Enova and its public utility subsidiaries act as one company and effectively dispose of jurisdictional facilities as that term is used in section 203. The facts in this case are similar to the facts in Enova-Pacific. By virtue of the merger between NorAm Energy and Houston Industries, there will be a transfer of control of NorAm from NorAm Energy to New Houston Industries and New NorAm Energy. Similar to our determination in Enova-Pacific, for purposes of section 203, NorAm Energy and its public utility subsidiary will act as one company and effectively dispose of jurisdictional facilities as that term is used in section 203 18/ As we state in Enova-Pacific, the Commission may disregard corporate form and regard a parent and its subsidiary as a unit in order to determine whether statutory mandates would be frustrated by the proposed transaction 19/ We also reject, for the reasons we give in rejecting similar arguments in Enova-Pacific, NorAm's arguments that attempt to rely on Missouri Basin and Illinois Power and that attempt to distinguish Central Vermont and Central Illinois. 20/

We reject NorAm's argument that the prohibitions and standards of conduct imposed upon it pursuant to its market-based rate authorization and the Commission's oversight concerning its power marketing activities prevent the disposition of its jurisdictional facilities. The conditions cited by NorAm have no bearing on the question of jurisdiction over the proposed merger. NorAm's argument, carried to its logical conclusion, would mean

16/ See Enova-Pacific, 79 FERC at _____, slip op. at 21.

17/ Enova's two public utility subsidiaries are San Diego Gas & Electric Company (SDG&E), a traditional public utility, and Enova Energy, a power marketer.

18/ See Enova-Pacific, 79 FERC at _____, slip op. at 22-23.

19/ Id. at _____, slip op. at 22.

20/ Id. at _____, slip op. at 23-25.

the Commission could not assert jurisdiction over dispositions of most public utility facilities since we have oversight of, and place conditions on, virtually all utilities that engage in jurisdictional sales. Traditional and non-traditional utilities (such as power marketers) alike. 21/ Additionally, the argument that we should not assert jurisdiction because we have continuing jurisdiction over power marketing authorizations under section 205 is equally applicable to any other entity to whom section 203 might apply. Indeed, this argument could be used to render section 203 a nullity. Simply put, the fact that we have oversight of, and may impose conditions on the sales of, power marketers such as NorAm is unrelated to the issue of the Commission's jurisdiction over the disposition of NorAm's jurisdictional facilities. 22/

Finally, the fact that Central Vermont and Central Illinois were not appealed and, thus, have not been reviewed by an appellate court, is irrelevant. NorAm cites no authority and we are aware of none, suggesting that Commission orders that have not been affirmed by an appellate court are inherently unreliable as precedent.

21/ For example, pursuant to Order Nos. 888 and 889, all transmission-owning public utilities must follow certain standards of conduct, including the requirement that they separate transmission operations from wholesale marketing personnel. See Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888 61 Fed. Reg. 21,540, 21,590-591 (May 10, 1996), FERC Stats. & Regs. 31,036 at 31,722, clarified, 76 FERC 61,009 and 76 FERC 61,347 (1996), order on reh'g, Order No. 888-A, 62 Fed. Reg. 12,274 (March 14, 1997), FERC Stats. & Regs. 31,048 (1997), reh'g pending; Open Access Same-Time Information System and Standards of Conduct, Order No. 889, 61 Fed. Reg. 21,737, 21,748 (May 10, 1996), FERC Stats. & Regs. 31,037 at 31,603 (1997), order on reh'g Order No. 889-A, 62 Fed. Reg. 12,484 (March 14, 1997) FERC Stats. & Regs. 31,049 (1997). Similarly, traditional public utilities that sell power at market-based rates cannot permit their captive customers to cross-subsidize their market rate actions.

22/ We make no determination here concerning what impact, if any, the proposed disposition of jurisdictional facilities would have on NorAm's authorization to sell power at wholesale at market-based rates. We will address that issue, if necessary, in a future order, either in response to NorAm's notice of change in status in Docket No. ER97-1247-000 or in addressing NorAm's application in Docket No. EC97-24-000.

In sum, based on our legal analysis in Enova-Pacific, which we incorporate by reference herein, and our analysis of the arguments and facts raised herein, we conclude that the proposed merger between NorAm Energy and Houston Industries involves the disposition of NorAm's jurisdictional facilities and that such disposition requires prior Commission approval pursuant to section 203 of the FPA. As noted, NorAm has filed, in Docket No. EC97-24-000, an application for authorization for its proposed reorganization contingent upon our finding jurisdiction over the proposed reorganization in this proceeding. We intend to act on the pending application in Docket No. EC97-24-000 expeditiously.

The Commission orders:

NorAm's request to disclaim jurisdiction is hereby denied.

By the Commission.

(S E A L)

Lois D. Cashell,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR PART 2

(Docket No. RM96-6-000)

Inquiry Concerning the Commission's Merger Policy
Under the Federal Power Act:
Policy Statement

ORDER NO. 592

POLICY STATEMENT

(Issued December 18, 1996)

AGENCY : Federal Energy Regulatory Commission.

ACTION : Policy Statement.

SUMMARY : The Federal Energy Regulatory Commission (Commission) is amending its regulations to update and clarify the Commission's procedures, criteria and policies concerning public utility mergers in light of dramatic and continuing changes in the electric power industry and the regulation of that industry. The purpose of this Policy Statement is to ensure that mergers are consistent with the public interest and to provide greater certainty and expedition in the Commission's analysis of merger applications.

EFFECTIVE DATE: This Policy Statement is effective immediately.

Docket No. RM96-6-000

- 2 -

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Elizabeth Anne Moler, Chair;
Vicky A. Bailey, James J. Hoecker,
William L. Massey, and Donald F. Santa, Jr.

Inquiry Concerning the)
Commission's Merger Policy)
Under the Federal Power Act;) Docket No. RM96-6-000
Policy Statement)

ORDER NO. 592

POLICY STATEMENT ESTABLISHING FACTORS THE COMMISSION
WILL CONSIDER IN EVALUATING WHETHER A PROPOSED MERGER
IS CONSISTENT WITH THE PUBLIC INTEREST

(Issued December 18, 1996)

I. INTRODUCTION

This Policy Statement updates and clarifies the Federal Energy Regulatory Commission's (Commission) procedures, criteria and policies concerning public utility mergers in light of dramatic and continuing changes in the electric power industry and corresponding changes in the regulation of that industry. The Commission believes it is particularly important to refine and modify its merger policy at this critical juncture for the electric industry. The Commission recognizes that the electric industry now is in the midst of enormous technological, regulatory and economic changes. At the heart of these changes is the transition to competitive power supply markets, prompted in part by this Commission's open access transmission policies. These changes are fundamental, and mergers and consolidations are among the strategic options available for companies seeking to reposition themselves in response to the emerging competitive business landscape.

In this Policy Statement, the Commission has two broad goals. First, we intend to ensure that future mergers are consistent with the competitive goals of the Energy Policy Act of 1992 (EPAct) 1/ and the Commission's recent Open Access Rule. 2/ This means that the Commission, in applying the Federal Power Act standard that mergers must be consistent with the public interest, must account for changing market structures and pay close attention to the possible effect of a merger on competitive bulk power markets and the consequent effects on ratepayers. Second, the Commission believes that as the pace of industry change increases, market participants require greater regulatory certainty and expedition of regulatory action in order to respond quickly to rapidly changing market conditions. Accordingly, this Policy Statement offers procedural innovations and more specific information that we would expect applicants to file to facilitate the Commission acting more quickly on merger requests. 3/

We will generally take into account three factors in analyzing proposed mergers: the effect on competition, the

- 1/ Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776, 2905 (1992).
- 2/ See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, (Open Access Rule) 61 FR 21,540 (May 10, 1996), III FERC Stats. & Regs. 31,036 (1996), reh'g pending.
- 3/ In the near future, the Commission will also issue a notice of proposed rulemaking to set forth more specific filing requirements consistent with this Policy Statement and additional procedures for improving the merger hearing process.

effect on rates, and the effect on regulation. First, our analysis of the effect on competition will more precisely identify geographic and product markets and will adopt the Department of Justice/Federal Trade Commission Merger Guidelines (Guidelines) as the analytical framework for analyzing the effect on competition. The Guidelines adopt a five-step procedure for analyzing mergers:

First, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market, properly defined and measured. Second, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects.

Third, the Agency assesses whether entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern. Fourth, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. Finally, the Agency assesses whether, but for the merger, either party to the transaction would be likely to fail,

causing its assets to exit the market. [4/]

By applying an analytic "screen" based on the Guidelines early in the merger review process, the Commission will be able to identify proposed mergers that clearly will not harm competition.

Second, in assessing the effect of a proposed merger on rates, we will no longer require applicants and intervenors to estimate the future costs and benefits of a merger and then litigate the validity of those estimates. Instead, we will require applicants to propose appropriate rate protection for customers. The most promising and expeditious means of addressing this issue is for parties to engage in a pre-filing consensus-building effort that will result in a filing that includes appropriate rate protection. If merger applicants and their affected wholesale customers are able to agree on appropriate ratepayer safeguards, it should not be necessary to set this aspect of the merger for hearing. 5/ Even where the parties have been unable to come to an agreement before the merger is filed, they should continue to attempt to negotiate a settlement. While there are several potential mechanisms available, which we discuss herein, adequate ratepayer protection will necessarily depend on the particular circumstances of the

4/ U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, issued April 2, 1992, 57 FR 41,552 (1992).

5/ Parties may choose to use alternative dispute resolution or other settlement processes to reach mutually agreeable ratepayer protection resolutions.

merging utilities and their ratepayers. There is no one-size-fits-all approach, and the Commission strongly encourages parties to resolve this issue without a formal hearing. However, we also recognize the possibility that parties may not be able to reach an agreement on appropriate ratepayer protection and that there may be situations in which the Commission nevertheless would be able to approve a merger. This could occur either after a hearing or on the basis of parties' filings if we determine that the applicants' proposal sufficiently insulates the ratepayers from harm.

Finally, with regard to the effect of the merger on regulation, we will adopt the approach we have used in recent cases. With respect to shifts of regulatory authority to the Securities and Exchange Commission (SEC) where the applicants will be part of a registered public utility holding company, they may either commit themselves to abide by this Commission's policies with regard to affiliate transactions, or we will set the issue for hearing. With respect to the merger's effect on state regulation, where the state commissions have authority to act on the merger, we intend to rely on the state commissions to exercise their authority to protect state interests.

In order to provide more certainty and expedition in our handling of merger applications, this Policy Statement explains how merger applicants should address each of the three factors as part of their case-in-chief in support of their application. For the effect on competition factor, applicants who demonstrate that

their merger passes the market power screen established in this Policy Statement will establish a presumption that the merger raises no market power concerns. In that event, a trial-type hearing on this factor should not be necessary. We are also setting forth guidance on the other two factors and ways to resolve any concerns about these factors without a trial-type hearing.

For mergers that do not pass the market power screen, we will engage in a more detailed analysis, which may include a trial-type hearing. As discussed below, if we find that a merger will have an adverse effect on competition, and if the additional factors examined do not mitigate or counterbalance the adverse competitive effects of the merger, we may impose various remedies where necessary to make a merger consistent with the public interest.

In this Policy Statement, we also provide guidance on what kind of evidence is needed for each factor. Thus, applicants will be able to provide the necessary information at the outset. This should provide more certainty and help focus our review on specific issues that require more scrutiny. We believe that the additional information that we would expect parties to file will expedite the merger review process and enable the Commission to act on section 203 applications more quickly. We intend to process most merger applications within 12-15 months after the applications are completed, as discussed below under "Procedures."

In general, we expect that a merger approved by the Commission will satisfy each of the three factors that form the basis of our merger review, i.e., post-merger market power must be within acceptable thresholds or be satisfactorily mitigated, acceptable customer protections must be in place, and any adverse effect on regulation must be addressed. However, we recognize that there may be unusual circumstances in which, for example, a merger that raises competitive concerns may nevertheless be in the public interest because customer benefits (such as the need to ensure reliable electricity service from a utility in severe financial distress) may clearly compel approval. Consistent with the Guidelines, the Commission would continue to account for such circumstances and could, in a particular case, conclude that on balance the merger is consistent with the public interest.

Finally, the Commission recognizes that, as the industry evolves to meet the challenges of a more competitive marketplace, new types of mergers and consolidations will be proposed. For example, in addition to mergers between public utilities, market participants already are considering restructuring options that include mergers between public utilities and natural gas distributors and pipelines, consolidations of electric power marketer businesses with other electric or gas marketer businesses, and combinations of jurisdictional electric operations with other energy services. 6/ As a consequence, our

6/ See, for example, among others, the proposed merger of Enron Corporation with Portland General Corporation (Docket No.

(continued...)

merger policy must be sufficiently flexible to accommodate the review of these new and innovative business combinations that are subject to our jurisdiction under section 203 and to determine their implications on competitive markets. We believe that the analytical framework articulated in this Policy Statement provides a suitable methodology for determining whether such mergers will be consistent with the public interest. 7/ However, it will not be necessary for the merger applicants to perform the screen analysis or file the data needed for the screen analysis in cases where the merging firms do not have facilities or sell relevant products in common geographic markets. In these cases, the proposed merger will not have an adverse competitive impact (i.e., there can be no increase in the applicants' market power unless they are selling relevant products in the same geographic markets) so there is no need for a detailed data analysis. If the Commission is unable to conclude that the applicants meet this standard, the Commission will require the applicants to supply the competitive analysis screen data described in Appendix A.

6/(...continued)

ER96-36-000) and the proposed acquisition of PanEnergy Corporation by Duke Power Company, announced November 25, 1996.

7/ We recognize that, as some energy products possibly become more suitable alternatives to others or as the combination of complementary energy services possibly affects barriers to entry the focus of our analysis may have to be adjusted to encompass those products, markets, and factors that are relevant to analyzing the exercise of market power in the future business environment.

II. BACKGROUND

Section 203(a) of the Federal Power Act (FPA) provides that no public utility shall sell, lease, or otherwise dispose of the whole of its facilities that are subject to the Commission's jurisdiction, or any part thereof with a value in excess of \$50,000, or by any means whatsoever, directly or indirectly, merge or consolidate such facilities with those of any other person, or purchase, acquire, or take any security of another public utility without first securing the Commission's approval.

8/ Section 203(a) also says that "if the Commission finds that the proposed . . . [merger] will be consistent with the public interest, it shall approve the same." 9/ Under section 203(b), the Commission may approve a proposed merger "in whole or in part and upon such terms and conditions as it finds necessary or appropriate. . . ." This power is to be exercised "to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission." 10/

Thirty years ago, in the Commonwealth case, 11/ the

8/ While many types of transactions, including relatively minor ones, may require section 203 authorization, this Policy Statement focuses on mergers.

9/ 16 U.S.C. 824b(a) (1994).

10/ 16 U.S.C. 824b(b) (1994).

11/ See Commonwealth Edison Company (Commonwealth), Opinion No. 507, 36 F.P.C. 927, 936-42 (1966), aff'd sub nom. Utility Users League v. FPC, 394 F.2d 16 (7th Cir. 1968), cert. denied, 393 U.S. 953 (1969).

Commission set forth six non-exclusive factors for evaluating mergers:

- (1) the effect of the proposed merger on competition;
- (2) the effect of the proposed merger on the applicants' operating costs and rate levels;
- (3) the reasonableness of the purchase price;
- (4) whether the acquiring utility has coerced the to-be-acquired utility into acceptance of the merger;
- (5) the impact of the merger on the effectiveness of state and federal regulation; and
- (6) the contemplated accounting treatment.

Of these factors, the first two -- the effect on competition and the effect on costs and rates -- have presented the most significant issues in recent merger cases.

Since Commonwealth, however, both the electric utility industry and utility regulation have changed dramatically. The Commission's Open Access Rule 12/ describes these changes at length. Advances in technology now allow scale economies to be exploited by smaller-size units, thereby allowing smaller new plants to be brought on line at costs below those of the large plants of the 1970s and earlier. 13/ Technological advances in transmission have made possible the economic transmission of

12/ See Open Access Rule, 61 FR at 21,540.

13/ See Id. at 21,544.

electric power over long distances at higher voltages. 14/ State public utility commissions have been relying more on competitive contracting as the primary vehicle for adding new generating capacity. 15/ This Commission has authorized market-based rates for wholesale electricity sales when it has found that the public utilities lack market power.

In 1992, a landmark change occurred when Congress enacted the EPAct. That statute permitted new power suppliers, called exempt wholesale generators, to enter wholesale power markets, and expanded the Commission's authority to require transmitting utilities to provide eligible third parties with transmission access. In 1996, consistent with the competitive goals of EPAct, the Commission adopted a sweeping regulatory policy change with the promulgation of the Open Access Rule. That rule requires each public utility that owns, operates or controls interstate transmission facilities to file an open access transmission tariff that offers both network and point-to-point service. The rule is designed to remedy the undue discrimination that is inherent when a utility does not offer truly comparable transmission service to others, and to promote competitive bulk power markets. Thus, EPAct and the Commission's Open Access Rule have fundamentally changed federal regulation of the electric

14/ See Id. at 21,544-45.

15/ See Paul L. Joskow, *Regulatory Failure, Regulatory Reform, and Structural Change in the Electrical Power Industry*, in *Brookings Papers on Econ. Activity, Microeconomics* 125 (1989).

utility industry. In addition, many states are contemplating retail access, which may prompt even more significant changes in the industry.

Because these changes have implications for the Commission's regulation of mergers, 16/ we issued a Notice of Inquiry (NOI) 17/ soliciting comments on whether our thirty-year-old criteria for evaluating mergers should be revised. While most commenters agree that we should revise our merger policies, there are differences of opinions on the general direction of the change needed. The comments are summarized in Appendix D. 18/

III. DISCUSSION

A. General Comments on Revising Merger Policy

1. Direction of Change

As noted above, under section 203, the Commission evaluates mergers to determine whether they are "consistent with the public interest." Congress did not intend the Commission to be hostile to mergers. 19/ We have found that the transaction taken as a whole must be consistent with the public interest. 20/ Thus,

16/ Many of the commenters in the Open Access Rule proceeding suggested that the Commission reevaluate its merger policy in concert with the open access rulemaking. See Open Access Rule at 61 FR 21,555.

17/ See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act, Docket No. RM96-6-000, 61 FR 4,596 (February 7, 1996), FERC Stats. & Regs. 35,531.

18/ Appendix C sets forth the full names and acronyms of the commenters.

19/ Pacific Power & Light Co. v. FPC, 111 F.2d 1014, 1016 (9th Cir. 1940) (PP&L); also see Northeast Utilities Service Co. v. FERC (NU), 993 F.2d 937 (1st Cir. 1993).

(continued...)

even if certain aspects of a proposed merger are detrimental, the merger can still be consistent with the public interest if there are countervailing benefits that derive from the merger. 21/

Almost all commenters argue that we need to revise our merger policies and standards in light of the changes in the industry. 22/ On one side, many commenters argue that mergers may prevent markets from becoming truly competitive. 23/ On the other side, some commenters suggest that the Commission should approve a merger unless harm to the public interest is demonstrated. 24/ These commenters claim that most mergers are procompetitive and should be approved unless a problem is identified.

We do not agree either with commenters who argue that we should actively encourage mergers or those who argue that we should discourage them. The statutory standard is that a merger must be "consistent with" the public interest. While we believe that the Commission has broad flexibility in determining what is in the public interest, particularly in light of changing conditions in the industry, we do not read the statutory language

20/ (...continued)

20/ Entergy Services Inc. and Gulf States Utilities Company (Entergy), Opinion No. 385, 65 FERC 61,332 at 62,473 (1993), order on reh'g, Opinion No. 385-A, 67 FERC 61,192 (1994), appeal pending.

21/ See NU, 993 F.2d at 945.

22/ See Appendix D, Section IA.

23/ For example, APPA, NRECA at 7-8; ELCON at 12-13.

24/ For example, Utilicorp United at 2, 7, 10.

as creating a presumption against mergers. 25/ Nor are we prepared to presume that all mergers are beneficial. It is the applicants' responsibility to demonstrate that the merger is consistent with the public interest.

We believe that if the Commission is to fulfill its statutory responsibilities, it must determine what is consistent with the public interest in light of conditions in the electric industry in general as well as the specific circumstances presented by a proposed merger. In an era of traditional, cost-of-service based regulation, the Commission defined its public interest responsibilities consistent with that structure. Today, we believe that the public interest requires policies that do not impede the development of vibrant, fully competitive generation markets. We are refining our analysis of the effects of proposed mergers on competition in order to protect the public interest in the development of such highly competitive markets, as discussed below.

The Commission's interpretation of the public interest standard has never been static. In the El Paso case, 26/ we explained that our view of what it takes to mitigate market power sufficiently to allow approval of a merger had evolved over time.

25/ In *NU*, 993 F.2d at 947, the court pointed out that the FPA differs from the Bank Merger Act in that the latter contains an "implicit presumption that mergers are to be disapproved."

26/ *El Paso Electric Company and Central and Southwest Services Inc.*, 68 FERC 61,181 61,914-15 (1994), dismissed, 72 FERC 61,292 (1995).

We pointed out that as the industry had become more competitive, we began examining market power in transmission more closely, and that comparable access was now required. Moreover, we explained in El Paso that while in the past we had focused only on increases in market power, we no longer believed that we could find any merger to be consistent with the public interest, whether or not the merger created increased market power, unless the merging utilities provided open access. We adopted this revised view of the public interest in light of EPAct's goal of encouraging greater wholesale competition and the significant increase in actual competition.

2. How to Implement New Policies

We are adopting our new policies through this Policy Statement rather than through other means, such as acting on a case-by-case basis or through a rulemaking. While some commenters suggested other means, ^{27/} we believe that a Policy Statement is needed. Proceeding on a case-by-case basis would not give applicants and intervenors the guidance needed to facilitate the presentation of the kinds of well-focused evidence and arguments that will improve and expedite the merger review process. On the other hand, a binding rule would be too rigid at this time. Because the industry continues to change rapidly, we must maintain flexibility in fulfilling our statutory responsibilities.

Commenters disagree on whether we should apply the new

^{27/} See Appendix D at Section IB.

policy to pending merger proposals. 28/ Those proposing mergers have been on notice since we issued the NOI that the Commission is considering revising its criteria for evaluating proposed mergers. In several recent merger hearing orders, we have discussed the NOI and have indicated that we intend to evaluate pending proposals in light of any new criteria we might adopt. 29/ We do not believe that any applicants will be seriously disadvantaged by application of this policy to pending cases. Our analysis of the effect of a proposed merger on competition has been evolving for some time, particularly since the enactment of EPAct and the issuance of the Open Access Rule. Thus, we are not applying radically new analyses or standards. The same is true of the other two remaining factors, the effects on regulation and on rates. We will address the specific application of the policy to pending cases on a case-by-case basis. If necessary, we will require the parties to supplement the record in any pending case, and we do not expect that this will cause any substantial delay. In fact, if anything, we expect this Policy Statement will make it easier to resolve any remaining issues, because of our clarification of our policies.

B. Effect on Competition and Remedies

28/ Id.

29/ Union Electric Company and Central Illinois Public Service Company (Union Electric), 77 FERC 61,026 (1996), reh'g pending; Public Service Company of Colorado and Southwestern Public Service Company (PS Colorado), 75 FERC 61,325 (1996), reh'g pending; Baltimore Gas & Electric and Potomac Electric Power Company, 76 FERC 61,111 (1996).

1. Background

In response to the NOI, we received many comments on our market power analysis. Commenters generally divide into two groups, one recommending stricter scrutiny of the effect of mergers on competition, while the other argues that less concern is warranted in today's more competitive environment.

Those in the first group support more stringent scrutiny because they believe that mergers can cause competitive harm, particularly in a transitional era. Many commenters 30/ argue that mergers increase generation market power, increase monopsony buying power, encourage self-dealing, discourage alternative suppliers under retail access, and tend to preserve certain competitive advantages associated with vertical integration. These commenters criticize the analysis the Commission has been using to evaluate mergers. They argue that the Commission has not given enough consideration to important factors, including generation dominance, the effect of transmission constraints on competition, the merged company's ability to exercise market power in localized areas and in short-term energy sales, the effects on markets in which little or no effective competition exists, and the significant anticompetitive advantages that vertically integrated utilities possess as a result of the long-existing statutory and regulatory system.

30/ These include, for example, CA Com, Joint Consumer Advoc., APPA, NRECA, Environmental Action et al., RUS, Salt River, Lubbock, Wisconsin Customers, and TAPS.

The second broad group of commenters 31/ argues that mergers are procompetitive. These commenters maintain that mergers lower costs, create economies of scale and geographic scope, create large strong competitors, allow rapid movement into new markets, allow diversification to minimize shareholder exposure to business fluctuation, and let the most efficient companies operate facilities, among other reasons.

2. Discussion

a. The Role of Competition

The electric industry's rapid restructuring, and the Commission's regulatory response to it, have made the effect of mergers on competition, and the way the Commission evaluates that effect, critically important.

The Open Access Rule was a watershed for electric industry regulation. In the Rule, we recognized that, where it exists, competition has become the best way to protect the public interest and to ensure that electricity consumers pay the lowest possible price for reliable service. Before the Open Access Rule, the Commission took the approach that traditional regulation could cure many market power problems. The size of the company, the territory it covered, and the assets it held did not matter greatly because regulatory oversight could hold market power in check. Indeed, the creation of larger utilities allowed some utilities to take advantage of scale economies and pass the cost savings on to consumers under regulatory supervision.

31/ Such as UtiliCorp, Southern, PanEnergy, and Southwestern.

With the open transmission access resulting from the Open Access Rule and the continuing evolution of competitive wholesale power markets, we believe that competition is now the best tool to discipline wholesale electric markets and thereby protect the public interest. But the competition needed to protect the public interest will not be efficient and deliver lower prices in poorly structured markets. For example, a concentration of generation assets that allows a company to dominate a market will dampen or preclude the benefits of competition. In sum, as customer protection is increasingly dependent upon vibrant competition, it is critically important that mergers be evaluated on the basis of their effect on market structure and performance.

This means that the Commission must find ways to assess more accurately the competitive impact of merger proposals. In doing so, however, we must be sensitive to another pressing concern: the industry's need for more analytic and procedural certainty from the Commission. The increased pace of merger proposals has tested our ability to respond in a timely way. We recognize that merger proposals are business decisions made in response to market pressures and opportunities. Some merger proposals may strengthen weak firms and create stronger competitors. Some, however, may result in firms that will dominate or manipulate electricity markets and thwart competition. In either case, applicants are entitled to timely decisions from this Commission. The policies and procedures adopted in this Policy Statement are intended to promote that goal.

b. Definition of Markets

An accurate assessment of the effect on markets depends on an accurate definition of the markets at issue. The Commission's current analytic approach defines geographic markets in a manner that does not always reflect accurately the economic and physical ability of potential suppliers to access buyers in the market. This approach uses what has come to be known as a hub-and-spoke method. It identifies affected customers as those that are directly interconnected with the merging parties. It then identifies potential suppliers as: (1) those suppliers that are directly interconnected with the customer (the "first-tier" suppliers); and (2) those suppliers that are directly interconnected with the merging parties and that the customer thus can reach through the merging parties' open access transmission tariff (the "second-tier" suppliers).

A drawback of this method of defining geographic markets is that it does not account for the range of parameters that affect the scope of trade: relative generation prices, transmission prices, losses, and transmission constraints. Taking these factors into account, markets could be broader or narrower than the first- or second-tier entities identified under the hub-and-spoke analysis. For example, a supplier that is directly interconnected with a buyer may not be an economic supplier to that buyer if transmission capability across that interconnection is severely constrained or if the transmission charges are greater than the difference between the decremental cost of the

buyer and the price at which the supplier is willing to sell. In contrast, a supplier that is three or four "wheels" away from the same buyer may be an economic supplier if the sum of the wheeling charges and the effect of losses is less than the difference between the decremental cost of the buyer and the price at which the supplier is willing to sell. In other words, mere proximity is not always indicative of whether a supplier is an economic alternative.

Another concern with the approach we have used in the past is its analytic inconsistency. It defines the scope of the market to include the directly interconnected utilities that are accessible due to the applicants' open access tariff, but does not expand the market to recognize the access afforded by other utilities' tariffs. This was acceptable before open access was established as an industry-wide requirement for public utilities. Now that virtually all public utilities have open access transmission tariffs on file, it is no longer appropriate to recognize only the effect of certain entities' tariffs on the size of the market.

In modifying our competitive analysis, we are adopting the Guidelines as the basic framework for evaluating the competitive effects of merger proposals. The Guidelines are a well-accepted standard approach for evaluating the competitive effects of mergers, and they received substantial support from commenters.

c. Use of the Guidelines

The Guidelines set out five steps for merger analysis: (1)

define markets likely to be affected by the merger and measure the concentration and the increase in concentration in those markets; (2) evaluate whether the extent of concentration and other factors that characterize the market raise concerns about potential adverse competitive effects; (3) assess whether entry would be timely, likely, and sufficient to deter or counteract any such concern; (4) assess any efficiency gains that reasonably cannot be achieved by other means; and (5) assess whether either party to the merger would be likely to fail without the merger, causing its assets to exit the market. We note, however, that the Guidelines are just that -- guidelines. They provide analytical guidance but do not provide a specific recipe to follow. Indeed, applying the Guidelines to the electric power industry is one of our biggest analytic challenges, both because the industry is evolving very rapidly and because the industry has some unique features, such as very limited opportunities for storage (hence the importance of time-differentiated markets). An analysis that follows the Guidelines still requires many assumptions and judgments to fit specific fact situations.

While this Policy Statement provides guidance on how the Commission intends to more sharply focus its analysis of a merger's effect on competition, we cannot reduce this analysis to a purely mechanized computation of the same data inputs for all merger applications. Rather, the Commission will need to evaluate the relevant product and geographic markets affected by each merger proposal; these markets, in turn, depend on the

specific characteristics of the merger applicants and the products and markets in which they potentially trade.

Consequently, mergers may require analysis of different product and geographic markets due to factors (such as the existence of constrained transmission paths) that affect the size of a particular market or the hours in which trade of the product is critical to determine whether merger applicants possess market power. Such distinguishing factors will need to be identified and analyzed on a case-by-case basis. Thus, the analytical process explained in this Policy Statement is a framework under which appropriate adjustments may be required to be incorporated to take account of factors unique to a merger. Furthermore, as noted above, this Policy Statement also is intended to be sufficiently flexible to accommodate the kinds of new merger proposals that will be presented to the Commission as the energy industry evolves to meet the challenges of a more competitive marketplace.

We note that the Guidelines contemplate using remedies to mitigate any harm to competition. There will be mergers where, at the end of an analysis, market power concerns persist but that could be made acceptable with measures to mitigate potential market power problems. We encourage applicants to identify market power problems and to propose remedies for such problems in their merger proposals. In many cases, such a remedy could avoid the need for a formal hearing on competition issues and thus result in a quicker decision. As discussed further in

Section III B (2) (e), if a proposed long-term remedy is not capable of being effectuated at the time the merger is consummated, applicants may propose effective interim remedial measures.

d. Analytic Screen

It is important to give applicants some certainty about how filings will be analyzed and what will be an adequate showing that the merger would not significantly increase market power. This will allow applicants to avoid or minimize a hearing on this issue. Consequently we will to use an analytic screen (described in Appendix A) that is consistent with the Guidelines. If applicants satisfy this analytic screen in their filings, they typically would be able to avoid a hearing on competition. We would expect applicants to perform the screen analysis as part of their application and to supply the Commission and the public with electronic files of all data used in the analysis as well as other related specified data. The Commission will need this information in order to perform its competitive analysis. If an adequately supported screen analysis shows that the merger would not significantly increase concentration, and there are no interventions raising genuine issues of material fact that cannot be resolved on the basis of the written record, the Commission will not set this issue for hearing. Applicants may, of course, submit an alternative competitive analysis in addition to the screen.

The Commission believes that the screen will be a valuable

analytical tool in all cases. It is conservative enough so that parties and the Commission can be confident that an application that clears the screen would have no adverse effect on competition. The screen also will be valuable in identifying potential competitive problems early in the process. The result will be more narrowly focused issues at hearings when they are necessary. We also note that the screen is intended to be somewhat flexible. It sets out a general method, but we will consider other methods and factors where applicants properly support them.

We believe that the analytic screen will produce a reliable, conservative analysis of the competitive effects of proposed mergers. However, it is not infallible. In some cases, the screen may not detect certain market power problems. There also may be disputes over the data used by applicants or over the way applicants have conducted the screen analysis. These claims may be raised through interventions and by the Commission staff. However, such claims must be substantial and specific. In other words, they should focus on errors in or other factual challenges to the data or assumptions used in the analysis, or whether the analysis has overlooked certain effects of the merger. Unsupported, general claims of harm are insufficient grounds to warrant further investigation of an otherwise comprehensive analysis developed by the applicants. Intervenor may also file an alternative competitive analysis, accompanied by appropriate data, to support their arguments. The Commission realizes that

the need for more rigor in intervention showings could require additional efforts by potential intervenors. We will therefore routinely allow 60 days from filing for intervenors and others to comment on a merger filing. 32/

A detailed illustrative description of the analytic screen that we will use is in Appendix A. The following is a brief summary of the screen. There are four steps the applicant must complete and the Commission will follow:

- (1) Identify the relevant products. Relevant products are those electricity products or substitutes for such products sold by the merging entities.
- (2) Geographic markets: identify customers who may be affected by the merger. Generally, these would include, at a minimum, all entities directly interconnected to a merging party and those that historical transaction data indicate have traded with a merging party.
- (3) Geographic markets: identify potential suppliers that can compete to serve a given market or customer. Suppliers must be able to reach the market both physically and economically. There are two parts to this analysis. One is determining the economic capability of a supplier to reach a market. This is

32/ Merger applicants that wish to facilitate the merger review process should serve potential intervenors with copies of their filing (via overnight delivery), including electronic versions, when they file their applications with the Commission. Cf. Open Access Rule, 61 FR 21,618 n.510.

accomplished by a delivered price test, which accounts for the supplier's relative generation costs and the price of transmission service to the customer, including ancillary services and losses. The second part evaluates the physical capability of a supplier to reach the customer, that is, the amount of electric energy a supplier can deliver to a market based on transmission system capability.

- (4) Analyze concentration. Concentration statistics must be calculated and compared with the market concentration thresholds set forth in the Guidelines. 33/

The usefulness of the screen analysis depends critically on the data that are supplied with the application. These data are described in Appendix A. Applicants should file in electronic format the data specified as well as any other data used in their analysis.

If the Guidelines' thresholds are not exceeded, no further

- 33/ The Guidelines address three ranges of market concentration: (1) an unconcentrated post-merger market -- if the post-merger Herfindahl-Hirschman Index (HHI) is below 1000, regardless of the change in HHI the merger is unlikely to have adverse competitive effects; (2) a moderately concentrated post-merger market -- if the post merger HHI ranges from 1000 to 1800 and the change in HHI is greater than 100, the merger potentially raises significant competitive concerns; and (3) a highly concentrated post-merger market -- if the post-merger HHI exceeds 1800 and the change in the HHI exceeds 50 the merger potentially raises significant competitive concerns; if the change in HHI exceeds 100, it is presumed that the merger is likely to create or enhance market power.

analysis need be provided in the application. As stated earlier, if an adequately supported screen analysis shows that the merger would not significantly increase concentration, and there are no interventions raising genuine issues of material fact that cannot be resolved on the basis of the written record, the Commission will not set this issue for hearing. If the thresholds are exceeded, then the application should present further analysis consistent with the Guidelines. The Commission will also consider any applicant-proposed remedies at this stage. If none is presented, or if the analysis does not adequately deal with the issues, we will need to examine the merger further.

The Commission will set for hearing the competitive effects of merger proposals if they fail the above screen analysis, if there are problems concerning the assumptions or data used in the screen analysis, or if there are factors external to the screen which put the screen analysis in doubt. We may also set for hearing applications that have used an alternative analytic method the results of which are not adequately supported. As discussed in Section III F, the Commission will attempt to summarily address issues where possible and may use procedural mechanisms that permit us to dispose of issues without having a trial-type hearing.

e. Mitigation

Although a competitive analysis pursuant to the Guidelines may show that a proposed merger would have anticompetitive effects, the Commission may be able to approve the merger as

consistent with the public interest if appropriate mitigation measures can be formulated. In the past, in some cases the Commission has conditionally approved a merger if applicants agreed to conditions necessary to mitigate anticompetitive effects. In some instances, applicants themselves have voluntarily offered commitments to address various concerns. 34/ Commenters suggested a variety of conditions that we could impose (or remedies that applicants could adopt voluntarily) to solve competitive problems with a merger. These include, for example, the formation of an Independent System Operator (ISO), divestiture of assets, elimination of transmission constraints, efficient regional transmission pricing, and offering an open season to allow the merging utilities' customers to escape from their contracts. Other commenters oppose some or all of these remedies. Some commenters also argue that we should monitor the situation after a merger and impose any new remedies that are needed; other commenters oppose such post-merger review. 35/

As noted, the Commission's review of merger applications has frequently resulted in the development of particular conditions

34/ E.g., Northeast Utilities Services Company/Re Public Service Company of New Hampshire, 50 FERC 61,266, reh'g denied, 51 FERC 61,177, clarification, 52 FERC 61,046 (1990), order on reh'g, 58 FERC 61,070 (1992), order on reh'g 59 FERC 61,042 (1992), aff'd in part sub nom. Northeast Utilities Services Company v. FERC, 993 F.2d 937 (1st Cir. 1993); Midwest Power Systems, Inc. and Iowa-Illinois Gas & Electric Company, 71 FERC 61,386 (committed to offer wholesale requirements customers an open season).

35/ The comments on remedies are summarized in more detail in Appendix D, Section VI D.

that are designed to remedy problems associated with the merger. These conditions are imposed as part of our approval of the merger application. We expect that practice to continue. For example, we expect the competition analysis to focus extensively on generation market power and on whether a proposed merger exacerbates market power problems. We also expect applicants to propose remedies for market power problems identified in their analysis. It is our hope that as our market power analysis becomes more refined to cope with changing circumstances in the industry, applicant-proposed remedies or mitigation strategies will also become more refined or tailored to address the identified harm. Of course, one remedy that an applicant could consider is to propose to divest a portion of its generating capacity so that its market share falls below the share that poses anticompetitive concerns under the Guidelines. This remedy is discussed in the Appendix A section entitled "Competitive Analysis Screen."

Similarly, an applicant's ability to exercise generation market power may be affected by transmission constraints and transmission pricing. In particular, the scope of the geographic market may be limited both by transmission constraints and by the need to pay cumulative transmission rates in order to transmit power across the systems of the merging utilities and neighboring utilities. It is likely that both market concentration and the applicant's market share would be greater within such a circumscribed geographic market. Hence, the opportunity to

exercise market power also would be greater. Potential remedies for such market power could include the following. First, a proposal by the applicants to turn over control of their transmission assets to an ISO might mitigate market power. In particular, an ISO might facilitate the implementation of efficient transmission pricing and thereby expand the effective scope of the geographic market. Second, an up-front, enforceable commitment to upgrade or expand transmission facilities might mitigate market power, because the constraint relieved by such an upgrade or expansion no longer would limit the scope of the relevant geographic market. These and other remedies also are discussed in Appendix A. We intend to tailor conditions and remedies to address the particular concerns posed by a merger on a case-by-case basis.

If an applicant does not propose appropriate remedies to mitigate the anticompetitive impact of a merger, the Commission intends to fashion such remedies during the course of its consideration of an application.

We do not intend to rely on post-merger review or on new remedies imposed after a merger is approved. We must find that a merger is consistent with the public interest before we approve a merger. 36/ Moreover, heavy reliance on post-merger review would expose the merging entities to too much uncertainty. However, as

36/ For example, an expansion or upgrade of facilities to alleviate a transmission constraint would not be an acceptable mitigation measure unless uncertainties about the utilities' ability to complete the upgrade or expansion are resolved prior to consummation of the merger.

the Commission has noted in past merger cases, the Commission does retain authority under section 203(b) to issue supplemental orders for good cause shown as it may find necessary or appropriate. 37/

The Commission acknowledges that many of the solutions that would mitigate market power or anticompetitive effects cannot be implemented quickly and, in fact, could take an extended period to accomplish (e.g., siting and constructing new transmission lines to alleviate a transmission constraint, divestiture of generation assets, formation of an ISO). While long-term remedies may be necessary to allow the Commission to determine that a merger is consistent with the public interest, a requirement to satisfy such conditions prior to consummating a merger may jeopardize the ability of parties to merge. In turn, customers will experience unnecessary delays in receiving benefits accruing from the merger. Therefore, we will entertain proposals by merger applicants to implement interim mitigation measures that would eliminate market power concerns during the period that it takes to put in place the long-term remedies necessary to address the anticompetitive effects of their proposed merger. 38/ Such interim measures must fully and effectively address the specific market power problems identified

37/ See FPA section 203(b), 16 U.S.C. 824b(b) (1994).

38/ For example, an applicant could sell its transmission rights on congested transmission paths to third parties or not trade in markets where it has market power until long-term remedies are implemented.

for the merger but should not be viewed as substitutes for the long-term remedies required by the Commission. Applicants should implement long-term remedies as quickly as practical.

C. Effect on Rates

1. Background

In determining whether a merger is consistent with the public interest, one of the factors we have considered is the effect the proposed merger will have on costs and rates. In the past we have considered whether the elimination of the independence of the companies and resulting combination of the facilities of the separate entities would be likely to lead to unnecessary rate increases or inhibit rate reductions. 39/ We have also been concerned with whether the merged companies would be able to operate economically and efficiently as a single entity. 40/ In connection with these concerns, the Commission has investigated applicants' claims about the potential costs and benefits of their proposed mergers and weighed that information to determine whether the costs are likely to exceed the benefits. Our investigations have frequently required trial-type hearings. Although we have considered the applicants' burden of proof to be met by a generalized showing of likely costs and benefits, 41/ these hearings have often been time-consuming, and there has been

39/ Commonwealth, 36 FPC at 938.

40/ Edison, 47 FERC 61,196 at 61,672 (1989).

41/ Entergy Services Inc. (Entergy), 65 FERC 61,332, at 62,473 (1993), order on reh'g, 67 FERC 61,192 (1994), appeal pending.

considerable controversy over whether the estimates of future costs and benefits are truly meaningful. Moreover, there has been controversy over the position we have taken that benefits are to be "counted" even if they could reasonably be obtained by means other than the merger. There also has been controversy over the allocation of the projected merger benefits. 42/

In more recent cases, the Commission has focused on ratepayer protection. We have either accepted a hold harmless commitment (a commitment from the applicant that any net merger-related costs will not raise rates) or have set for hearing the issue of whether the applicants' hold harmless commitment or some other proposed ratepayer protection was adequate. For example, in Primergy, the Commission held that wholesale ratepayers would be adequately protected if the applicants were to commit that, for a period of four years after the merger is consummated, the merging companies would not seek to increase rates to wholesale requirements customers.

In PS Colorado, 43/ the applicants submitted evidence on costs and benefits, but also proposed a hold harmless commitment. We noted several concerns with the hold harmless commitment, pointing out that it did not cover most of the merger-related costs. 44/ We set for hearing the issue of whether the

42/ These benefits have included items such as fuel cost savings; bankruptcy resolution; reducing administrative and general costs; lowering net production costs; and eliminating or deferring construction of new generating units.

43/ 75 FERC at 62,043-44.

(continued...)

applicants' hold harmless commitment provided adequate protection for ratepayers (those who receive unbundled generation and transmission services as well as those who receive bundled service) and, if not, what ratepayer protection mechanisms would be sufficient. We did not set for hearing the effect on rates as such; that is, we did not instruct the administrative law judge to conduct a factual investigation into the alleged costs and benefits of the merger. In Cincinnati Gas & Electric Company and PSI Energy, Inc., the Commission modified the hold harmless provision, stating that the applicants would have the burden of convincingly demonstrating in future section 205 filings that their wholesale customers had, in fact, been held harmless; that is, they would have to show any rate increase was not related to the merger. 45/ The applicants would be required to make an affirmative showing in their initial case-in-chief that their proposed rates did not reflect merger-related costs unless such

44/ (...continued)

44/ The commitment was not to seek an increase in base rates for five years after the merger. We found, however, that this provided little protection, since the five years would be over before most of the claimed merger savings were projected to be realized. Moreover, the applicants proposed to amortize merger-related costs over five years, but their hold harmless commitment covered only costs that would be "booked to the merger" through the first two years.

45/ See Cincinnati Gas & Electric Company and PSI Energy, Inc., 64 FERC 61,237 at 62,714 (1993), order withdrawing authorization of merger and instituting settlement procedures 66 FERC 61,028, order denying rehearing and approving settlements and unilateral offers as conditioned and modified, 69 FERC 61,005 (1994), order granting clarification, 69 FERC 61,088 (1994).

costs were offset by merger-related benefits. 46/

In Union Electric, 47/ the applicants proposed an open season guarantee for the first five years after the merger was consummated. The open season guaranteed that existing wholesale customers could terminate their contracts by giving notice on the day the applicants filed for a rate increase affecting that customer. The Commission was concerned that the open season commitment might not provide adequate protection for wholesale ratepayers (those that receive bundled generation and transmission service as well as those that receive unbundled generation or transmission service) and set that issue for hearing. We stated that if at hearing it was determined that the open season commitment was not adequate protection, a determination should be made as to what ratepayer protection mechanisms might be suitable for the proposed merger.

In response to the NOI, only a few commenters suggest that we dispose of the effect on rates factor altogether. 48/ Most commenters consider this factor to be essential in deciding whether to approve a merger. 49/ However, commenters differ on how this factor should be assessed.

2. Discussion

We disagree with the argument presented by a few commenters

46/ Id. at 62,714.

47/ 77 FERC 61,026 at 61,107-08 (1996), reh'g pending.

48/ See Appendix D, section III(A).

49/ Id.

that we need not be concerned about the effect of a merger on rates in this competitive environment because prices will be set by market forces and customers can choose their suppliers accordingly. Also, while it may be true that most of the rate issues in connection with the typical merger affect retail ratepayers and are subject to state jurisdiction, the Commission in order to ensure that a merger is consistent with the public interest still must protect the merging utilities' wholesale ratepayers and transmission customers from the possible adverse effects of the merger. As mentioned in our discussion above on the effect on competition and in our discussion in the Open Access Rule, we recognize that even in an open access environment, markets may not work perfectly or even well. 50/ This is particularly the case during the transition from a monopoly cost-of-service market structure to a competitive market-based industry. For instance, during the transition some customers may be unable to take immediate advantage of competition because of contractual commitments or because of stranded costs obligations. Furthermore, because transmission remains effectively a natural monopoly and will continue to be regulated on a cost-of-service basis, the Commission has reason to be concerned that mergers do not affect transmission rates adversely. For these reasons, we will not abandon the effect on

50/ See Open Access Rule, 61 Fed. Reg. at 21,553.

rates factor. 51/

Rather than requiring estimates of somewhat amorphous net merger benefits and addressing whether the applicant has adequately substantiated those benefits, we will focus on ratepayer protection. Merger applicants should propose ratepayer protection mechanisms to assure that customers are protected if the expected benefits do not materialize. The applicant bears the burden of proof to demonstrate that the customer will be protected. This puts the risk that the benefits will not materialize where it belongs -- on the applicants.

Furthermore, we believe that the most promising and expeditious means of addressing ratepayer protection is for the parties to negotiate an agreement on ratepayer protection mechanisms. The applicants should attempt to resolve the issue with customers even before filing, and should propose a mechanism as part of their filing. Even if these negotiations have not succeeded by the time of filing, the parties should continue to try to reach a settlement. What constitutes adequate ratepayer protection necessarily will depend on the particular circumstances of the merging utilities and their ratepayers, and we strongly encourage parties to minimize contentious issues and to resolve them without the time and expense of a formal hearing. Parties may not be able to reach an agreement on an appropriate

51/ In the past, we have referred to this factor as the "effect on costs and rates." However, the basic concern is with the effect on rates. Accordingly, we will refer to it as the "effect on rates."

ratepayer protection and the Commission may still be able to approve the merger. As mentioned earlier, this could occur either after a hearing or on the basis of parties' filings if we determine that the applicants' proposal sufficiently insulates the ratepayers from harm.

As described above, the Commission has accepted a variety of hold harmless provisions, and parties may consider these as well as other mechanisms if they appropriately address ratepayer concerns. Among the types of protection that could be proposed are:

open season for wholesale customers - applicants agree to allow existing wholesale customers a reasonable opportunity to terminate their contracts (after notice) and switch suppliers. This allows customers to protect themselves from merger-related harm.

general hold harmless provision - a commitment from the applicant that it will protect wholesale customers from any adverse rate effects resulting from the merger for a significant period of time following the merger.

Such a provision must be enforceable and administratively manageable.

moratorium on increases in base rates (rate freeze) - applicants commit to freezing their rates for wholesale customers under certain tariffs for a significant

period of time. 52/

rate reduction - applicants make a commitment to file a rate decrease for their wholesale customers to cover a significant period of time. 53/

Although each mechanism provides some benefit to ratepayers, we believe that in the majority of circumstances the most meaningful (and the most likely to give wholesale customers the earliest opportunity to take advantage of emerging competitive wholesale markets) is an open season provision. We urge merger applicants to negotiate with customers before filing and to offer an adequate open season proposal or other appropriate ratepayer protection mechanism in their merger applications. If intervenors raise a substantial question as to the adequacy of the proposal, parties should continue to pursue a settlement. If no agreement can be reached, we may decide the issue on the written record or set the issue for hearing.

D. Effect on Regulation

When the Commission in Commonwealth referred to impairment of effective regulation by this Commission and appropriate state

52/ A rate freeze, however, does not insulate the merged utility from a rate reduction if the Commission, pursuant to section 206, determines that the utility's rates are no longer just and reasonable. Also, in circumstances in which ratepayers clearly would be entitled to a rate reduction in the absence of the merger e.g. expiration of a current surcharge or some other clearly defined circumstance, a simple rate freeze may not provide adequate ratepayer protection.

53/ Whether these types of proposals are appropriate in a particular case will depend on the circumstances of the merging companies and the customers and the details of the proposals.

regulatory authorities, its concern was with ensuring that there is no regulatory gap. 54/ The potential for impairment of effective regulation at the Federal level has been increased by the Ohio Power decision. 55/ That case holds that if the SEC approves a contract for sales of non-power goods or services between affiliates in a registered holding company, this Commission in its rate review may not disallow any part of the payment under the contract in order to protect ratepayers against affiliate abuse. 56/

In recent cases, the Commission has developed its policy regarding the effect of proposed mergers on both state and Federal regulation. For instance, PS Colorado involved the creation of a new multistate registered holding company. On the question of a shift of regulation from the state commissions to this Commission, we declined to order a hearing, noting that the state commissions had authority to disapprove the merger and that they did not argue that their regulation would be impaired. On the question of a shift of authority from this Commission to the SEC, we pointed out that pre-merger, we had authority to review for rate purposes all the costs the companies incurred, but if the merger were approved, under Ohio Power we would lose that

54/ Cinergy, 64 FERC at 62,710 n.278; Commonwealth, 36 FPC at 931.

55/ Ohio Power Company v. FERC, 954 F.2d 779, 782-86 (D.C. Cir. 1992), cert. denied, 498 U.S. 73 (1992) (Ohio Power).

56/ Cf. AEP Power Marketing, Inc., 76 FERC 61,307 at 62,515 (1996).

authority if the SEC approved an inter-affiliate transaction. Thus, the costs could be flowed through to ratepayers, even if the goods or services were obtained at an above-market price or the costs were imprudently incurred. To guard against this possibility, we gave the applicants two options. 57/ They could either choose to have the issue set for hearing, or they could agree to abide by our policies on intra-system transactions. 58/

In response to the NOI, commenters generally argue that it is important for the Commission to continue to look at the effect of a merger on the effectiveness of state and Federal regulation. 59/

2. Discussion

We will continue to examine the effect on regulation as a factor in our analysis of proposed mergers and will use the approach adopted in PSColorado and subsequent cases. Thus, in situations involving registered public utility holding companies, we will require the applicants to choose between two options and to make that choice clear in their filing. They may commit themselves to abide by this Commission's policies with respect to intra-system transactions within the newly-formed holding company

57/ 75 FERC at 62,045-46.

58/ Accord, Union Electric, 77 FERC at 61,108-09 (state expressed concern over shift of regulatory authority from itself and this Commission to SEC; Commission noted that state had authority to disapprove merger).

59/ Appendix B at Section IV.

structure, or they may go to hearing on the issue of the effect of the proposed registered holding company structure on effective regulation by this Commission. If applicants choose the first option, we will set the issue for hearing only if intervenors raise credible arguments that because of special factual circumstances, the commitment will not provide sufficient protection.

With respect to the effect of a merger on state regulatory authority, where a state has authority to act on a merger, as in PSColorado, we ordinarily will not set this issue for a trial-type hearing. The application should tell us whether the states have this authority. If the state lacks this authority and raises concerns about the effect on regulation, we may set the issue for hearing; we will address these circumstances on a case-by-case basis.

B. Other Commonwealth Factors

The other Commonwealth factors are evidence of coercion, the proposed accounting treatment, and the reasonableness of the purchase price.

These three factors elicited very little comment. As to evidence of coercion, a few commenters suggest that this should be evaluated by the marketplace rather than by the regulatory process. 60/ Several commenters say that this factor should be

60/ East Texas Coop., EEI, PaineWebber, and Southern Company.

considered only if someone demonstrates that it is relevant. 61/ OK Com is among the few commenters who favor retaining this factor. It suggests that coercion is a means by which some companies will try to gain oligopolistic control of the market in the coming competitive environment.

As to accounting treatment, some commenters support elimination of accounting concerns as a factor. 62/ PaineWebber notes that most recent mergers were mergers of equals, involving minimal premiums over current market prices. It suggests that a similar market discipline would likely cause shareholders to reject merger transactions involving large merger premiums and excessive amortization. Florida and Montaup argue that the accounting treatment of a merger should not be an issue for hearing unless an applicant seeks treatment different from the Commission's standards. Southern Company contends that the Commission's analysis of this factor should be subsumed within the analysis of the merger's impact on costs and rates.

NY Com and OK Com are concerned about the accounting consequences of mergers. OK Com favors keeping the historical cost approach to accounting for plant acquisitions during mergers and business combinations until competitive market structures are achieved at the national, regional, and state levels. NY Com

61/ Florida and Montaup.

62/ East Texas Coop, EEI, and PaineWebber. Although they do not support keeping this factor EEI and PaineWebber suggest that in light of broad industry changes, this may be the right time for a generic re-examination of accounting concerns, of which accounting for mergers could be a part.

also urges the Commission to continue to require unrestricted access to all books and records of newly merged entities.

We also received a few comments on looking at the reasonableness of the purchase price as a factor. A number of commenters 63/ urge that the Commission not substitute its judgment for the workings of market forces, which will determine the reasonableness of the purchase price. Others 64/ believe that this issue should be examined only if its relevance is raised. However, OK Com argues that purchase price still has some relevance in this era of diversification. It is concerned that the purchase price may be based on expected returns on non-regulated investments, which, if they fail to materialize, may dilute the value of utility stock.

We will no longer consider these three matters as separate factors. Any evidence of coercion will be considered as part of our analysis of the effect of the merger on competition. We have treated the reasonableness of the purchase price as an issue only insofar as it affects rates, so this issue is subsumed in the effect on rates factor. As for the proposed accounting treatment, this is not really a factor to be balanced along with other factors; proper accounting treatment is simply a requirement for all mergers. 65/

63/ CINergy, East Texas Coop, EEI, PaineWebber, and Southern.

64/ Florida and Montaup.

65/ See, e.g., Public Service Company of Colorado and Southwestern Public Service Company, 75 FERC 61,325 (continued...)

If a merger application seeks to recover acquisition premiums through wholesale rates, we will address the issue in post-merger rate applications. However, the Commission historically has not permitted rate recovery of acquisition premiums.

F. Procedures for Handling Merger Cases

We received many suggestions as to how to improve our procedures for handling merger cases. The commenters focused particularly on the need for certainty and the need to expedite the process, at least for some mergers. They suggested various screens or hold harmless provisions. Some suggested that we set forth filing requirements. There were also many comments on coordination with other agencies that are reviewing the merger. 66/

Although we plan to issue a Notice of Proposed Rulemaking in the near future to set forth more specific filing requirements consistent with this Policy Statement and additional procedures for improving the merger hearing process, we have determined that the best way to improve the Commission's handling of merger proposals is to update our merger review policy. As outlined in this Policy Statement, we will generally limit the number of factors we examine in order to determine whether a merger is in

65/ (...continued)

(1996); Entergy Services, Inc. and Gulf States Utilities Company, Opinion No. 385, 65 FERC 61,332 (1993), order on reh'g, 67 FERC 61,192 (1994).

66/ Appendix D, Section VI.

the public interest.

The principal area that will require a fact-based review is the effect of a proposed merger on competition. By using the Guidelines as a screen and by informing applicants of the type of information we expect them to file with us when they apply, we hope to expedite our review of applications considerably.

As discussed above under "Effect on Competition," "Effect on Rates," and "Effect on Regulation," we are setting forth for each factor guidance to enable merger applicants ordinarily to avoid a trial-type hearing or to have a hearing focused on limited issues. Moreover, we have set forth above under "Effect on Competition" and in Appendix A the information that we think we need at this point to determine whether a merger would impair competition. We have also discussed ways to mitigate anticompetitive effects. Our consideration of the other two factors, the effect on rates and the effect on regulation, should not require a lot of data or analysis, since we will be relying primarily on the applicants' commitments. This should make it possible for applicants to make filings that can be processed more quickly. The Commission intends to propose a rule to set forth detailed filing requirements.

Another step that can make our processing of merger applications more efficient is to discourage redundant or irrelevant pleadings. We agree with commenters who argue that we should not consider extraneous issues, and we will not consider interventions that raise matters unrelated to the merger.

Moreover, in the past, the process has been bogged down by repetitive filings such as answers to answers. We will not consider such filings, nor will we consider "new" information unless it is genuinely new and relevant.

With all the streamlining changes discussed above, we believe that we will be able to act on mergers more quickly after a complete application is filed. A complete application is one that adequately and accurately describes the merger being proposed and that contains all the information necessary to explain how the merger is consistent with the public interest, including an evaluation of the merger's effect on competition, rates, and regulation. 67/ We expect applicants to be able to provide all the necessary information, given the guidance in this Policy Statement. We also emphasize that applicants should not expect speedy action if their merger proposals change, as has frequently happened in the past. The Commission cannot be expected to act quickly on a moving target. If applicants change the mechanism or terms under which they intend to merge or supplement the supporting information in their application, the Commission's review process will restart.

Once we have a complete application, we will make every reasonable effort to issue an initial order 60-90 days after the

67/ The information would include all applicable exhibits and accompanying testimony and other data that will constitute applicants' showing that the merger is consistent with the public interest. In addition a copy of all applications or other information filed with other regulatory bodies regarding the merger must be provided to the Commission to initiate our review process.

comment period closes. An initial order could take any of several actions, including: requesting additional information from the applicants or intervenors; setting some or all issues for a trial-type or paper hearing; approving the merger; or rejecting the merger. If we determine in the initial order that further procedures are necessary, we will choose among the available procedural options based on the completeness of the record before us, the types of issues that need to be resolved (factual, policy or legal), and the need to give parties adequate due process. However, we are hopeful that the guidance in this Policy Statement will result in more complete applications and more focused and detailed interventions and that we will be able to act summarily on many (or in some cases all) issues in the initial order.

If the Commission determines in an initial order that trial-type or paper hearing procedures are necessary, we believe that we will be able to issue a final order on most applications within 12-15 months from the date that the completed application was filed. We emphasize that this assumes no significant changes in the proposal; any such changes will start the process over and will require that a new notice be issued. Of course, some applications will take more time than others. For example, if a merger raises extraordinarily complex factual disputes, or if the development of competitive remedies or hold harmless agreements is entirely deferred to the hearing, case processing may take longer. On the other hand, if a merger falls below the HHI

screen, the applicants propose adequate ratepayer protection mechanisms, and the applicants make the commitments necessary to assuage our concerns about the effect on regulation, we should be able to act much more quickly.

The Commission believes that in order to meet routinely the target dates we have set forth in this Policy Statement, it is appropriate to reexamine whether our procedures for processing merger applications, including hearing procedures, can be tailored better to meet the specific needs of participants in merger proceedings. To that end, in the proposed rulemaking on information filing requirements (see note 3), we will also request public comment on merger processing procedures.

We will not delay our processing of merger applications to allow the states to complete their review, as some commenters suggest. However, we will be willing to consider late interventions by state commissions where it is practicable to do so. In cases where a state commission asks us to address the merger's effect on retail markets because it lacks adequate authority under state law, we will do so.

In response to commenters who are concerned that our decisions be consistent with those of other agencies, we note that since we are adopting the Guidelines as a framework for our analysis of the effect on competition, our analysis should be generally consistent with the DOJ's and the FTC's analyses.

G. Other Issues

According to FERC Policy Project, recent changes in the

industry may make mergers financially unattractive without planning and operational changes; these changes can harm the environment. FERC Policy Project argues that we should revise our rule that provides that merger applications will not generally require preparation of an EIS or EA. The rule "categorically excludes" mergers unless circumstances indicate that the action may be a major Federal action significantly affecting the quality of the human environment. 68/ FERC Policy Project also argues that the effect on the environment should be considered as a factor in deciding whether to approve a merger. Moreover, it believes we should require applicants to provide with their applications information on the environmental effects of the merger and that we should require mitigation of environmental effects through various means.

The Commission has recognized that a particular merger can have environmental effects and has been willing to study the issue in an individual case where it is justified. 69/ We do not see the need to change our regulation, which explicitly addresses the possibility that an EA or EIS may, on rare occasions, be needed. However, both our categorical exclusion rule and the absence of environmental concerns from the list of three factors in this Policy Statement reflect the simple fact that most mergers do not present environmental concerns.

68/ 18 C.F.R. 380.4(a)(16) and (b) (1996).

69/ See Southern California Edison Company, 47 FERC 61,196 (1989), order on reh'g, 49 FERC 61,091 (1989).

Low-Income Representatives argues that the "public interest" standard requires us to consider matters such as the need for service to all households, the need for consumer input into the decisions made by utilities, and other matters. We clarify that the three factors discussed in this Policy Statement are not necessarily the only factors that make up the public interest, and, if appropriate, we will consider other matters that are under our jurisdiction. However, we believe such matters as the need for service to all households are more appropriately the concern of the states.

IV. Administrative Effective Date and Congressional Notification

Under the terms of 5 U.S.C. 553 (d) (2), this Policy Statement is effective immediately. The Commission has determined, with the concurrence of the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget, that this Policy Statement is not a major rule within the meaning of section 351 of the Small Business Regulatory Enforcement Act of 1996. 70/ The Commission is submitting the Merger Policy Statement to both Houses of Congress and to the Comptroller General.

70/ 5 U.S.C. 804 (2).

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List of Subjects in 18 CFR Part 2

Administrative Practice and Procedure, Electric power,
Natural gas, Pipelines, Reporting and recordkeeping
requirements.

By the Commission.

(S E A L)

Lois D. Cashell,
Secretary.

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In consideration of the foregoing, the Commission amends Part 2, Chapter I, Title 18 of the Code of Federal Regulations as set forth below.

Part 2 -- GENERAL POLICY AND INTERPRETATIONS

1. The authority citation for Part 2 continues to read as follows:

Authority - 15 U.S.C. 717-717w, 3301-3432; 16 U.S.C. 792-825y, 2601-2645; 42 U.S.C. 4321-4361, 7101-7352.

2. Part 2 is amended by adding 2.26, to read as follows:

2.26 Policies concerning review of applications under section 203

(a) The Commission has adopted a Policy Statement on its policies for reviewing transactions subject to section 203. That Policy Statement can be found at 77 FERC 61,263, 61 FR (, 1996). The Policy Statement is a complete description of the relevant guidelines. Paragraphs (b) - (e) of this section are only a brief summary of the Policy Statement.

(b) Factors Commission will generally consider. In determining whether a proposed transaction subject to section 203 is consistent with the public interest, the Commission will generally consider the following factors; it may also consider other factors:

- (1) the effect on competition;
 - (2) the effect on rates; and
 - (3) the effect on regulation.
- (c) Effect on competition. Applicants should provide data

adequate to allow analysis under the Department of Justice/Federal Trade Commission Merger Guidelines, as described in the Policy Statement and Appendix A to the Policy Statement.

(d) Effect on rates. Applicants should propose mechanisms to protect customers from costs due to the merger. If the proposal raises substantial issues of relevant fact, the Commission may set this issue for hearing.

(e) Effect on regulation. (1) Where the merged entity would be part of a registered public utility holding company, if applicants do not commit in their application to abide by this Commission's policies with regard to affiliate transactions, the Commission will set the issue for a trial-type hearing;

(2) Where the affected state commissions have authority to act on the transaction, the Commission will not set for hearing whether the transaction would impair effective regulation by the state commission. The application should state whether the state commissions have this authority.

(3) Where the affected state commissions do not have authority to act on the transaction, the Commission may set for hearing the issue of whether the transaction would impair effective state regulation.

Appendix A

Competitive Analysis Screen

The analytic screen provides applicants with a standard analytic method and data specification to allow the Commission to quickly determine whether a proposed merger presents market power concerns. Some past merger cases were delayed or set for hearing because an adequate analysis was not part of the application or because sufficient data that would allow the Commission to corroborate or independently check applicants conclusions was not provided in the application. This is especially true regarding the effect that transmission prices and capability may have on the scope of the geographic market. The chances for hearings and delays will be reduced if the screen analysis and data described below are filed with the application.

A. Consistency With DOJ Guidelines

In this policy statement, the Commission has adopted the DOJ Merger Guidelines (the Guidelines) 71/ as the basic framework for evaluating the competitive effects of proposed mergers. The analytic screen applies the Guidelines. Before describing the screen, the Guidelines are briefly summarized so that the screen's consistency with them is clear.

In general, the Guidelines set out five steps for merger

71// U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, 57 Fed. Reg. 41,552 (1992).

analysis: (1) assess whether the merger would significantly increase concentration; (2) assess whether the merger could result in adverse competitive effects; (3) assess whether entry could mitigate the adverse effects of the merger; (4) assess whether the merger results in efficiency gains not achievable by other means; and (5) assess whether, absent the merger, either party would likely fail, causing its assets to exit the market.

The analytic screen focuses primarily on the Guidelines first step. This step can be broken down into two components:

Defining product and geographic markets that are likely to be affected by a proposed merger and measuring concentration in those markets. The products to consider are those sold by the merging parties. The Guidelines suggest a way of defining geographic markets based on identifying the suppliers that are feasible alternative suppliers to the merged firm from a buyer's perspective: the hypothetical monopolist test. Essentially, if a hypothetical and unregulated monopoly that owned all the supplies inside the geographic market being tested could profitably sustain a small but significant price increase (i.e., suppliers external to the market are not, by definition, sufficiently good substitutes for the buyers in the market), then the limit of the geographic market has been reached. 72/ The sustainability of a price increase depends on both sellers entering the market and the response of buyers to the increase. The concentration of

72// The Guidelines suggest that a 5% price increase be used for the test, but allow that larger or smaller price increases may also be appropriate. DOJ Guidelines at 41555.

suppliers included in the market is then measured (by summary statistics such as the Herfindahl-Hirschman Index, or HHI, and single seller market share) and used as an indicator of the potential for market power.

Evaluating the change in concentration using the Guidelines thresholds to indicate problematic mergers. The Guidelines address three ranges of market concentration: (1) an unconcentrated post-merger market -- if the post-merger HHI is below 1000, regardless of the change in HHI the merger is unlikely to have adverse competitive effects; (2) a moderately concentrated post-merger market -- if the post merger HHI ranges from 1000 to 1800 and the change in HHI is greater than 100, the merger potentially raises significant competitive concerns; and (3) a highly concentrated post-merger market -- if the post-merger HHI exceeds 1800 and the change in the HHI exceeds 50, the merger potentially raises significant competitive concerns; if the change in HHI exceeds 100, it is presumed that the merger is likely to create or enhance market power. 73/

If the concentration analysis indicates that a proposed merger may significantly increase concentration in any of the relevant markets, the Guidelines suggest examination of other factors that either address the potential for adverse competitive effect or that could mitigate or counterbalance the potential competitive harm. Such factors include the ease of entry in the

73// DOJ Guidelines at 41558.

market and any efficiencies stemming from the merger. 74/ If the additional factors examined do not mitigate or counterbalance the adverse competitive effects of the merger, remedial conditions would be explored at this stage.

B. Analytic Screen Components

There are four steps to the screen analysis.

1. Identify the relevant products.

The first step is to identify one or more products sold by the merging entities. Products may be grouped together when they are good substitutes for each other from the buyer's perspective. If two products are not good substitutes, an entity with market power can raise the price of one product and buyers would have a limited ability to shift their purchases to other products. In the past, the Commission has analyzed three products: non-firm energy, short-term capacity (firm energy), and long-term capacity. 75/ These remain reasonable products under the prevailing institutional arrangements, and applicants should recognize such products in their analysis. Other product definitions may also be acceptable. For example, the lack of on-site buyer storage creates products differentiated by time. Thus,

74// In assessing market concentration, the Guidelines state "...market share and concentration data provide only the starting point for analyzing the competitive impact of a merger." DOJ Guidelines at 41558 .

75// See Baltimore Gas & Electric and Potomac Electric Power Company, 76 FERC 61,111 (1996) at 61,572. The factor that is considered in evaluating long term capacity markets is the effect of a merger on barriers to entry into those markets.

peak and off-peak energy (seasonal and daily) may be distinct products.

The Commission encourages parties to propose even more precise definitions of relevant products where appropriate. Indeed, we would expect to see greater precision in product differentiation as market institutions develop.

2. Geographic markets: identify customers who may be affected by the merger.

This is the first of a two-step process of determining the geographic size of the market. To identify customers potentially affected by a merger, at a minimum, applicants should include all entities directly interconnected to either of the merging parties. Additional entities should be included in the analysis if historical transaction data indicates such entities have been trading partners with a merging party. Applicants and others may argue either that there are other customers to be included as relevant buyers or that identified customers are not relevant buyers. Intervenor also may argue that other customers not identified by the applicants will be affected by the merger.

3. Geographic markets: identify potential suppliers to each identified customer.

This second, and key, step in determining the size of the geographic market is to identify those suppliers that can compete to serve a given market or customer and how much of a competitive presence they are in the market. Alternative suppliers must be able to reach the market both economically and physically. There

are two parts to this analysis. One is determining the economic capability of a supplier to reach a market. This is accomplished by a delivered price test. The second part evaluates the physical capability of a supplier to reach a market, i.e., the amount of the defined product a supplier can deliver to a market based on transmission capacity availability.

Supply and demand conditions in electricity markets vary substantially over time, and the market analysis must take those varying conditions into account. Applicants should present separate analyses for each of the major periods when supply and demand conditions are similar. One way to do this is to group together the hours when supply and demand conditions are similar; for example, peak, shoulder and off-peak hours. There may even be smaller groupings to reflect periods of significantly constrained transmission capability available for suppliers to reach a market.

The screen analysis also examines historical trade data as a check on which suppliers should be included in the relevant markets.

a. Delivered price test.

The screen analysis should first identify those suppliers with the potential to economically supply power to the destination market or customer. The merging companies as well as non-traditional suppliers should be included in this test to identify potential suppliers. Basically, suppliers should be included in a market if they could deliver the product to a

customer at a cost no greater than 5¢ above the competitive price to that customer. 76/ The delivered cost of the product to the relevant market for each potential supplier is found by adding the potential supplier's variable generation costs and all transmission and ancillary service charges that would be incurred to make the delivery. 77/ Thus, the farther away a supplier, the more transmission and ancillary service prices that must be added to its power costs. Suppliers that would have to traverse a non-open access system can be included as potential suppliers only to the extent they have firm access rights. The analysis should also take into account the effect of line losses on the economics of trade with a distant supplier.

If a supplier can deliver the product to the market at a cost no more than 5¢ above the market price, that supplier should be included in the geographic market. Applicants are expected to provide product-specific delivered price estimates for each destination market or customer.

The delivered price test uses the following data. Applicants should provide in electronic format these data and any other data relied upon in their analysis.

Transmission prices. Applicants should use the ceiling prices in utilities' open access tariffs on file with

76// The Guidelines suggest a 5¢ price threshold but acknowledge that others may be appropriate. Applicants have the burden of justifying a different price threshold.

77// This would include the unbundled transmission rates of a seller that is a vertically integrated public utility.

the Commission. Where a non-jurisdictional entity's transmission system is involved, the ceiling price in its NJ tariff should be used. If the entity has not filed an NJ tariff, applicants should use their best efforts to secure or estimate transmission ceiling prices. Prices that are not found in a tariff on file with the Commission should be adequately supported. While we are aware that ceiling prices are frequently discounted, this screen analysis is to be conservative. Applicants may present an additional alternative analysis using discounted prices if they can support it with evidence that discounting is and will be available.

Potential suppliers' generation costs. The Commission will consider various measures of costs. Applicants are free to use any appropriate cost data as long as it is verifiable and supported with reasoned analysis. Possibilities include generating plant cost data from the FERC Form 1 annual reports or unit specific data. Another is system lambda data. Either of these data can be used to calculate a potential supplier's costs at various time periods. Other measures or data sources may also be appropriate. The Commission has not reached a firm conclusion on a specific cost measure.

Competitive market price. Electricity markets have not

sufficiently matured yet to exhibit single market clearing prices for various products. In addition, price discovery is difficult because the reporting of actual transaction prices is still in its formative stage. Until market institutions mature enough to reveal single market clearing prices, applicants may use surrogate measures as long as they are properly supported. For example, a buyer's system lambda may be used because a buyer is not likely to purchase from a supplier that is more costly than its own costs of production at specific times. 78/ Another possibility might be the price at which the affected customer has been purchasing power.

For each supplier, the screen analysis should then show the amount of each product the supplier could supply to the market. Generation capacity measures are appropriate for this showing. 79/ Different capacity measures should be used, as appropriate, for different products. It is also appropriate, even desirable, to use several measures for one product. Given that competitive analysis is an inexact science and that electricity markets are changing rapidly, using several measures for a particular product

78// System lambda data are usually reported by control area. For smaller entities that are within a control area, the area's system lambda may be a reasonable proxy for the cost of energy from the marginal resource.

79// The DOJ Guidelines support using capacity measures in industries with homogenous products, such as electricity. DOJ Guidelines, at 41557. We note that energy measures (MWH) may also be appropriate.

will corroborate the result of the analysis. While the Commission has not firmly decided on specific measures for analyzing products, the following discussion of capacity measures is intended to offer guidance on this matter. These are some ways to measure a supplier's ability to supply a particular product to a market. They are not product definitions.

Economic capacity. This is the most important of the measures because it determines which suppliers may be included in the geographic market. Economic capacity is that from generating units whose variable costs are such that they could deliver energy to a relevant market, after paying all necessary transmission and ancillary service costs, at a price close to the competitive price in the relevant market. For example, if the average competitive price in the wholesale market is 2.2 cents/kWh during a particular period, all capacity that can sell into the market at 2.3 cents/kWh (5¢ above the competitive price) should be included in the market. If a seller has no economic capacity, it should not be considered in the market at this stage of the analysis. The economic capacity measure provides a sense of which suppliers own or control the largest shares of low cost generating capacity that has a pronounced competitive advantage over higher cost

capacity in the market. 80/

Available economic capacity. This measure indicates how much economic capacity a supplier identified in the previous step might actually have available to sell into a market. It includes capacity from generating units that are not used to serve native load (or are contractually committed) and whose variable costs are such that they could deliver energy to a market at a price close to the competitive price in the market. The presumption underlying this measure is that the lowest running cost units are used to serve native load and other firm contractual obligations and would not be available for other sales. As competition develops, this presumption may not be valid. 81/ Because of its focus on variable costs, available economic capacity is useful for evaluating energy (in contrast to capacity) markets.

Uncommitted capacity. This traditional measure is useful for evaluating intermediate-capacity markets. For each supplier included in the relevant market, this measure is computed by subtracting native load and firm contractual obligations from total capacity.

80// Economic capacity and similar measures were recommended by the DOJ and FTC. See FTC comments at 10 and DOJ comments, Appendix at 8.

81// For example, in a market with full retail access and a bid-based power exchange, all generation units would be in the market.

Total capacity. Total capacity has traditionally been used by the Commission and others to analyze markets. While this measure does not account for native load obligations and does not capture the availability or cost of generation, and thus is not useful for a delivered price analysis, it does provide a sense of the overall size of a supplier that is included in the relevant market.

b. Accounting for transmission capability

Once the suppliers that might economically supply the product to a market or customer are identified, and the relevant capacity measures are calculated, each supplier's capacity measures should be adjusted to account for how much of the product that seller can physically deliver to that market. The extent of transmission capability determines the extent of a supplier's ability to physically reach a market.

The flows on a transmission system can be very different under different supply and demand conditions (e.g. peak vs. off-peak). Consequently, the amount and price of transmission available for suppliers to reach wholesale buyers at different locations throughout the network can vary substantially over time. If this is the case, the analysis should treat these narrower periods separately and separate geographic markets should be defined for each period.

It is important to assess accurately the amount of transmission capability available for each supplier's use. The

key to incorporating transmission limitations into the merger analysis is to include each supplier in the relevant market only to the extent of the transmission capability available to them. This would be calculated as the combination of the available transmission capability (ATC) ^{82/} and any firm transmission rights held by the supplier that are not committed to long-term transactions.

In many cases, multiple suppliers could be subject to the same transmission path limitation to reach the same destination market and the sum of their economic generation capacity could exceed the transmission capability available to them. In these cases, the ATC must be allocated among the potential suppliers for analytic purposes. There are various methods for accomplishing this allocation. Applicants should support the method used.

Applicants should also present evidence regarding how transmission capability will be affected by the merger. Transmission line loadings are likely to change as a result of the merging parties combined operations. These changes are likely to result in transmission availability that is different

^{82/} As used by the industry, ATC is a measure of the transfer capability remaining in the physical transmission network for further commercial activity over and above already committed uses. See for example NERC Available Transfer Capability Definitions and Determination, June 1996 at page 2. In hours when ATC is zero, a transmission constraint is said to be binding. This prevents the dispatcher from scheduling any additional transactions between the two points in the constrained direction.

from historical experience. Applicants should include in their application the following data: hourly TTC ^{83/} and hourly firm and non-firm ATC, and firm transactions between relevant control areas. The ATC and TTC data should come directly from the OASIS systems once they are implemented. Until then, applicants should file estimates of TTC and ATC with data or other background material that will allow the Commission to verify that the estimates are reasonable. Given these data, the Commission will be able to assess independently the amount of generation capacity that may be available to the market by each supplier.

c. Trade data check.

It would be expected that there be some correlation between the suppliers included in the market by the delivered price test and those actually trading in the market. As a check, actual trade data should be used to compare actual trade patterns with the results of the delivered price test. For example, it may be appropriate to include current trading partners in the relevant market even if the above analysis indicates otherwise.

Alternatively, if there has been little or no trade between a customer and a specific supplier, it may be appropriate to exclude that supplier from the market, unless the applicants can show why it should be included prospectively. The lack of open access in the past may have prevented trade between the entities

^{83/} As used by the industry, total transmission capability (TTC) is the amount of electric power that can be transferred over the interconnected network in a reliable manner while meeting all of a specific set of defined pre- and post-contingency conditions. NERC, id. at page 2.

but trade may be more likely in an open access environment.

Applicants should file historical trade data showing transactions between potential suppliers identified in the steps discussed above and the customers in question. The trade data filed should identify the supplier, customer, and characteristics of the transactions (duration, firmness, etc.). Any adjustments to the suppliers included in the market under the delivered price test must be fully supported.

4. Analyze concentration

The final step in the screen analysis is to analyze the effect of the proposed merger on market concentration and competition. To do so, concentration statistics should be calculated using the capacity measures discussed above for each relevant market identified. In cases where limited transmission capability during certain time periods results in a number of time differentiated markets, concentration statistics should be calculated for each. Both HHIs and single firm market share statistics should be presented for both pre- and post-merger conditions. 84/ In calculating HHIs and market shares, the

84// Post-merger geographic markets could include more or fewer suppliers than the pre-merger markets due to the effect of combining transmission rates. In cases where the merged company will charge a single system wide transmission rate, the merger will result in just one transmission rate where there were two before the merger. Thus after the merger, some suppliers that were excluded from some destination markets could be included if the elimination of one of the transmission charges allows them to economically reach the market. While a stable geographic market would be preferable for analytic reasons, the effect described here reflects the reality of current transmission pricing policy
(continued...)

relevant generation capacity of the customers in each market should be included in the denominator of the ratio statistics. For example, if the economic capacity measure is being used, then the customer's economic capacity should be included. Such capacity would be available and turned to as a response to a significant price increase by external suppliers.

The HHI measures should be compared with the thresholds given in the DOJ Merger Guidelines. The Guidelines address three ranges of market concentration: (1) an unconcentrated post-merger market--if the post-merger HHI is below 1000, the merger is unlikely to have adverse competitive effects regardless of the change in HHI; (2) moderately concentrated post-merger market--if the post merger HHI ranges from 1000 to 1800 and the change in HHI is greater than 100, the merger potentially raises significant competitive concerns; and (3) highly concentrated post-merger market--if the post-merger HHI exceeds 1800 and the change in the HHI exceeds 50, the merger potentially raises significant competitive concerns; if the change in HHI exceeds 100, it is presumed that the merger is likely to create or enhance market power. 85/

(...continued)

and market organization. A buyer inside the transmission area of one of the merging companies could see higher transmission rates as a result of a single system rate for the merged company thereby decreasing the competitive options available to it. We also note that a decrease in transmission prices paid could result in increased demand, congestion, and no increase of suppliers in some markets.

85// DOJ Guidelines, at 41558 .

If the Guidelines thresholds are not exceeded, no further analysis need be provided in the application. We emphasize, however, that the Guidelines are just that: guidelines. There will undoubtedly be instances where concentration statistics may fall just above or just below the thresholds for concern and some additional analysis or judgement is needed. 86/ For example, if a proposed merger's effect on concentration falls just below a threshold, the Commission might still want to see further analysis if intervenors have raised significant concerns regarding the proposed merger. It is reasoned analysis, not blind faith in the thresholds, that must carry the day.

Instances where high concentration is indicated in markets that are defined by fairly short-lived periods of low transmission capability will require additional analysis. The concern with high concentration in a market is that firms will be able to raise prices substantially and adversely impact the market. Relatively short periods of high concentration could be significant if the concentration is high enough. The factors that affect whether such a situation is problematic are the degree of concentration, as measured by HHI statistics, and how long that concentration lasts. High concentration is an indicator for how easy it would be for firms to behave

86// The Guidelines state that the HHI statistics provide a useful framework for merger analysis but they suggest greater precision than is possible with the available economic tools and information. Other things being equal, cases falling just above and just below a threshold present comparable competitive issues. Guidelines, at 41558.

strategically (e.g., collude, or if concentration is high enough, act unilaterally) to raise prices. It is a proxy measure for the degree to which prices could be raised. This, together with the length of time the concentration lasts, gives some idea of the potential severity of anticompetitive impact.

The Commission has insufficient experience to adopt at this time specific thresholds for the various possible combinations of HHI and length of time at which the constrained periods would be problematic. Applicants and other parties are strongly encouraged to analyze short-lived periods of high concentration using the framework discussed above and to support the conclusions drawn from it. There may be cases in which the applicant may be able to show that the anticompetitive effect of constrained transmission availability is de minimis. While the Commission has insufficient experience to establish a specific de minimis test in this policy statement, applicants may argue in a specific case that the anticompetitive effect of a constraint is de minimis. We offer the following general guidance to applicants that seek to make such a showing regarding short-lived transmission constraints. First, peak periods may be more problematic than other periods, because the opportunity to exercise market power likely would lead to significantly higher prices during those hours. Second, some level of market concentration above the DOJ threshold may be acceptable if the applicant can show that there are multiple sellers in the constrained area and/or that there are multiple holders of

capacity into the constrained area. And finally, our concern with short-lived periods of high concentration is greater if the merged firm will have market-based pricing authority. Without such authority, the firm may not be able to substantially raise prices.

If the DOJ Guideline concentration thresholds are exceeded, including instances where short-lived periods of high concentration are indicated to be problematic, then the application should present further analysis consistent with steps 2 to 5 in the Guidelines. The additional analysis could address the potential for adverse competitive effects, the potential for entry in the market and the role entry could play in mitigating the increased market power, any efficiency gains that reasonably could not be achieved by other means, and whether, but for the merger, either party would likely fail causing its assets to exit the market.

If entry is considered as a potential mitigating factor, applicants should address entry barriers, such as the time needed to install any necessary transmission capacity. All entry barriers should be addressed, even if they are not controlled by the applicants. Good market structure can be stymied by entry barriers, regardless of the source, e.g., transmission constraints on a neighboring utility's system.

C. Data

The usefulness of this screen depends on the quality and comprehensiveness of the data filed with the application. The

data needed for the screen generally are publicly available. It is important for applicants to file electronically all data used for the screen analysis, including supporting data, and the data specified in this policy statement. 87/ The Commission must be able to check on the applicants' analysis independently. To do so, the Commission must have ready access to the data.

Otherwise, data requests could result in delay. If there are problems in obtaining or understanding the data, the Commission is interested in developing informal means, such as technical conferences, to gather additional needed data or resolve questions or misunderstandings concerning the screen analysis, before the Commission addresses the merger. This approach could reduce the time needed to get useable data and perhaps reduce the need to set a merger for evidentiary hearing.

D. Other considerations

We note that the above description of the analytic screen focuses only on monopoly (seller) power. This is not intended to exclude monopsony (buyer) power as a relevant consideration. An analysis of monopsony power should be developed if appropriate. Long-term purchases and sales data for interconnected entities are already collected and could be used to assess buyer concentration in the same way that seller concentration is calculated. In any event, intervenors may raise this issue if it is a concern.

87// The data that should be electronically filed in an application is listed in Appendix B.

The Commission understands that the screen analysis described in this policy statement will evolve with industry restructuring and market maturation. For example, as unbundling occurs, companies may have market power for sales from individual generating units (e.g., must-run units). In addition, markets are developing in response to competition and are spawning new products and increasingly short term exchanges. Markets will probably be differentiated by product (e.g., firm and non-firm energy and reactive power), by time (e.g., peak, off-peak) or by geography (e.g., markets separated by transmission constraints). The definition of relevant geographic and product markets must account for these new realities. Further, methods for trading and information availability are changing. As regional institutions, such as ISOs, and regional markets develop, transmission services may no longer be a series of transactions based on utility-by-utility corporate boundaries, but rather single regional transactions. This will have important implications for entry, customer response to price changes, and the number of suppliers that have competitive delivered prices.

The means of our analysis may also change. For example, flow based network models that include constraints on transmission networks are likely to be needed for the screen analysis. In the future, the Commission will have to rely less on methods that use costs to assess markets. Generation cost data will become increasingly sensitive, market participants will be less willing to report them, and accounting costs will be

increasingly irrelevant to market behavior. The Commission will rely more on actual transaction prices because they will be more available as market institutions such as ISOs and power exchanges produce this information and because they are a better measure of market boundaries. New market institutions will change the ability to exercise market power. High transactions costs of trading tend to exclude competitors. Transactions costs include the costs of obtaining information, searching for trading partners, and completing a transaction. Further, the improved ability of buyers to respond quickly to price changes can significantly reduce market power. ISOs provide one vehicle for reducing transactions costs and making information available to traders via such means as the OASIS. Real-time pricing provides buyers with an improved ability to respond quickly to price changes.

We note that we intend to apply the analytic screen to mergers between firms that are not solely engaged in electricity markets, e.g., electric-gas mergers. However, it will not be necessary for the merger applicants to perform the screen analysis or file the data needed for the screen analysis in cases where the merging firms do not have facilities or sell relevant products in common geographic markets. In these cases, the proposed merger will not have an adverse competitive impact (i.e., there can be no increase in the applicants' market power unless they are selling relevant products in the same geographic markets) so there is no need for a detailed data analysis. If

the Commission is unable to conclude that the applicants meet this standard, the Commission will require the applicants to supply the competitive analysis screen data described in Appendix A.

D. Remedy

A problematic merger may be made acceptable if certain remedial actions are taken. In some cases, the Commission may recommend them if we determine that a proposed merger will cause significant adverse effects on competition without a remedy. In other cases, the applicants may propose certain actions to be taken if the Commission approves the proposed merger. We offer the following guidance concerning standards for remedies and specific remedial options.

1. Standards

Any remedies proposed by the applicants or relied upon by the Commission to mitigate the anticompetitive effect of a proposed merger should meet the following standards.

Nexus Remedies should be clearly designed to mitigate the specific competitive problems identified in the analysis.

Approval of other authorities Full and effective mitigation must be in place at the time the merger is consummated. Some, and maybe all, of the possible remedies to market power require the approval of other Federal, state and local authorities. For example, local authorities must approve many aspects of transmission line siting and construction and state commissions would surely have to approve any divestiture of generating plants

also used to provide retail service. Promises to the Commission that such actions will be taken in exchange for merger approval are empty if not accompanied by all approvals necessary. We recognize, however, that final approvals may require quite some time to secure. In such cases, we will consider interim mitigation measures that can be implemented more quickly so as not to unduly delay a merger's consummation. We will require, however, that any interim measure must be fully effective in mitigating the identified market power problems.

Specificity Remedial commitments must specify exactly which facilities are affected by the commitment, e.g., which generating unit(s) will be divested.

2. Remedial options

The remedies discussed in this section are intended to mitigate the market concentration problem caused by the merger. We stress that the options discussion is meant only as guidance and not as an exhaustive list of potentially acceptable remedies.

a) Require transmission expansion

Limitations on available transmission capability that prevent competitors from participating in a market can give substantial market power to incumbents in the market. Conditioning merger approval on eliminating a known constraint could help to mitigate this type of market power. Where constraints on other systems are a problem, the applicants would also be required to seek transmission expansion on those systems. As with relieving constraints on their own system, applicants

should show that all necessary approvals have been secured before the Commission could approve the merger. This process does not need to wait for the Commission to identify a problem.

Applicants wanting fast approval could include this as part of the application.

b) No trade over constrained paths

If constrained paths are responsible for market concentration problems and they cannot be relieved for any reason, the company could agree to not use those paths for its own off-system trade when other transmission service requests are pending. This condition would keep the merged company from exercising market power in trade in the constrained areas.

c) Generation plant divestiture

In concentrated markets, including those subject to severe and long lasting transmission limitations, splitting up different generating units into independent and separately owned companies could reduce horizontal market power. Where there are only a few generating units in the market area, divesting those units to just a few owners may not mitigate the market power problem. In such a case, one alternative might be to divest the ownership rights to each unit's energy and capacity to a number of owners. The unit could then be operated as a competitive joint venture and parts of its output could be bid or sold independently.

d) Defer to an ISO's analysis and mitigation efforts

Although ISOs are just now in their formative changes, they hold some promise of playing a part in mitigating certain sources of market power. Applicants' membership in, or commitment to join, an ISO with the authority necessary to mitigate market power could allow the Commission to rely on the ISO to identify and remedy market power problems. The ISO would have access to more information than does the Commission and would possess greater technical expertise to assess problems. More importantly the ISO would have the proper incentives to mitigate the problems if the ISO's governing body is broadly comprised of market participants. This potential role for ISOs highlights the critical importance of balanced ISO governance.

An ISO would also be a mitigating influence on market power to the extent that it attracts new entrants into a market. An ISO assures comparable and independent access to all customers. These institutional guarantees will serve both to attract new entrants and to encourage continued participation in markets that would otherwise be dominated by vertically integrated utilities.

ISOs are generally thought to be the proper vehicle for dealing with vertical market power, e.g., ensuring transmission expansion or preventing the strategic manipulation of generation dispatch. An ISO would be able to deal with horizontal market power issues to the extent it has the ability to control the dispatch or prices paid to generators. For example, an ISO could identify units with market power (such as must-run units) and

those units could be subject to contracts that mitigate those units ability to raise prices excessively. To take advantage of this option, applicants would be expected to show that: (1) the ISO meets the Commission s standard for independence; (2) already exists or will come into existence before the merger is completed; (3) has a mandate to identify both vertical and horizontal market power issues; and (4) has the authority to either remedy any problems it finds or bring those that it cannot remedy to the Commission.

e) Real-time pricing

Real-time pricing, when combined with other mitigation measures, could help constrain the ability of a firm to raise prices excessively. Buyers who can see the higher prices in real time can respond by conserving. This makes demand more elastic, thereby making it more difficult to exercise market power.

APPENDIX B

Data Used for Competitive Analysis Screen

Analysis	Data Element	Sources 88/
Delivered Price Test:		
	Hourly System Lambda	FERC Form No. 714
	Plant Generation	FERC Form No. 1
	Costs/Capability	
	Unit Generation Costs	
	- Heat Rates	EIA Form 860
	- Fuel costs	FERC Form 423
	Transmission Rates	Filed tariffs, Applicants filing
Transmission Capability Test:		
	Hourly Capability (ATC)	OASIS, Applicants filing
	Total Capability	OASIS, NERC Reports
Developing Capacity Measures:		
	Hourly System Lambda	FERC Form No. 714
	Plant Generation	FERC Form No. 1
	Costs/Capability	
	Unit Generation Costs	
	- Heat Rates	EIA Form 860
	- Fuel costs	FERC Form 423
	Transmission Rates	Filed tariffs, Applicants filing
Adjusting for LT Sales, Purchases, and NUGS:		
	Trade Data (Firm Capacity Sales)	FERC Form No. 1, OE-411, NERC Reports, Applicants filing
Adjusting for Tx Capability:		
	Hourly/Total Capability (ATC, TTC)	OASIS, NERC Reports Applicants filing

88// Most of the data listed is publicly available, however the Applicants should assemble the data and file it electronically with their merger application.

Appendix C

Commenters on Merger Notice of Inquiry

Short Name	Commenter
APPA	American Public Power Association
Attorneys General et al.	Attorneys General of the States of Iowa, Maine, Maryland, Minnesota,
Oklahoma and Wisconsin CA Com	California Public Utilities Commission
Carolina Association	Carolina Utility Customers Association, Incorporated
Centerior	Centerior Energy Corporation
Central and South West	Central and South West Corporation
CINergy	CINergy Corporation
Colorado Municipals Utilities	Colorado Association of Municipal Utilities
Com Ed	Commonwealth Edison Company
Competitive Coalition Market	Coalition for a Competitive Electric Market
Diamond and Edwards	Diamond, Joseph and Edwards, Jon D.
DOE	U. S. Department of Energy
DOJ	U. S. Department of Justice
East Texas Coop	East Texas Electric Cooperative, Incorporated
Economists Frankena)	Economists Incorporated (Mark W.
EEI	Edison Electric Institute
BGA	Electric Generation Association
Environmental Action et al.	Environmental Action Foundation and Consumer Federation of America
FERC Policy Project Policy	Project for Sustainable FERC Energy
Florida and Montaup Electric Company	Florida Power Corporation and Montaup Electric Company
FTC	Bureau of Economics of the Federal Trade Commission
Georgia Municipal Hawes and Behrends	Municipal Electric Authority of Georgia Hawes Douglas W and Behrends, Sam (IV)
Illinois Industrials	Illinois Industrial Energy Consumers
IN Com	Indiana Utility Regulatory Commission
Industrial Consumers	Electricity Consumers Resource Council, American Iron and Steel Institute and Chemical Manufacturers Association
International Brotherhood	International Brotherhood of Electrical Workers
Joint Consumer Advoc. People's Counsel	Joint Consumer Advocates of Maryland
KS Com	Kansas Corporation Commission
Low-Income	Consolidated Low-Income

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Representatives

Representatives

Commenters on Merger Notice of Inquiry (cont'd)

Short name

Commenter

Lubbock	Lubbock Power & Light
Madison G&E	Madison Gas and Electric Company
MidAmerican	MidAmerican Energy Company
Missouri Basin	Missouri Basin Municipal Power Agency
MN Public Service	Minnesota Department of Public Service
MO Com	Missouri Public Service Commission
NARUC	National Association of Regulatory
Utility Commissioners	
NIEP	National Independent Energy Producers
NM Industrials	New Mexico Industrial Energy Consumers
NRECA	National Rural Electric Cooperative
Association	
NRRI	National Regulatory Research Institute
NV Com	Public Service Commission of Nevada
NY Com	Public Service Commission of the State
of New York	
OH Com	Public Utilities Commission of Ohio
OK Com	Oklahoma Corporation Commission
OK Industrials	Oklahoma Industrial Energy Consumers
Otter Tail	Otter Tail Power Company
PA Com	Pennsylvania Public Utility Commission
PaineWebber	PaineWebber Incorporated
PanEnergy	PanEnergy Corporation
PP&L	Pennsylvania Power & Light Company
PS Colorado	Public Service Company of Colorado
RUS	Rural Utilities Service
Salt River	Salt River Project
Sierra Pacific	Sierra Pacific Power Company
Southern Company	Southern Company Services, Incorporated
Southwestern Electric	Southwestern Electric Cooperative,
Incorporated	
Southwestern PS	Southwestern Public Service Company
TAPS	Transmission Access Policy Study Group
TDU Systems	Transmission Dependent Utility Systems
Texas Industrials	Texas Industrial Energy Consumers
Texas Utilities	Texas Utilities Electric Company
TX Com	Public Utility Commission of Texas
UtiliCorp	UtiliCorp United Incorporated
WI Com	Public Service Commission of Wisconsin
Wisconsin Customers	Wisconsin Wholesale Customers
Wisconsin PS	Wisconsin Public Service Corporation

Appendix D

SUMMARY OF COMMENTS ON
MERGER POLICIES

I. General Comments on Revising the Commission's Merger Policy

A. Direction of Change

Almost all commenters argue that we need to revise our merger policies and standards in light of the changes in the industry. However, they do not agree on the direction of the change. On one side, many commenters argue that mergers may prevent markets from becoming truly competitive. 89/ On the other side, some commenters suggest that the Commission should approve a merger unless harm to the public interest is demonstrated. 90/ These commenters claim that most mergers are procompetitive and should be approved unless a problem is identified.

Commenters 91/ who argue that moving to a more competitive market warrants stricter merger approval criteria are concerned that the recent wave of mergers threatens the development of competitive markets. For example, Industrial Consumers and TAPS believe that the Commission's current policy is too lax. These commenters offer numerous reasons for opposing mergers including the detrimental effects of large "mega-utilities" and diversion of management's attention from cost minimization. RUS fears that mega-utilities could have market power in generation and political power at the state and federal levels that could suppress competition in transmission and distribution. Madison G&E is also concerned about the challenge mega-utilities pose to effective state regulation. UtiliCorp notes that the need for efficient dispositions and transfers of capital, which are critical to the transition from a regulated to a competitive industry, warrant a revised merger policy.

Many of these commenters criticize the "consistent with" standard as we have interpreted it -- that is, as a "do no harm" standard. They argue that this approach, which was developed in

89/ For example, APPA, NRECA at 7-8; ELCON at 12-13.

90/ For example, Utilicorp at 2, 7, 10.

91/ Among others, APPA, NRECA, EEI, Texas Utilities, Southern, East Texas Coop (endorsing the joint petition of APPA/NRECA and comments of NRECA), NIEP, Colorado Municipals (endorsing the views of APPA), IN Com, DOJ, Joint Consumer Advoc., TAPS, TX Com, and NY Com.

an era of tight regulation, is inconsistent with the public interest in the transition to a competitive environment. 92/ Joint Consumer Advoc. suggests that a merger is not consistent with the public interest unless dollars invested in a merger could not have been used otherwise to lower costs more.

Numerous commenters 93/ argue that we should revise our merger criteria because of general industry restructuring due to open access or new state and federal laws and policies that provide incentives to merge.

On the other hand, commenters who support more relaxed merger criteria argue that the marketplace can best decide the future path of the industry. They argue that the Commission's current policy is simply too stringent; 94/ we should recognize that the transformation to a competitive industry requires a certain amount of industry reshuffling, best accomplished without the Commission's intervention.

For example, CInergy believes that consolidation may be a necessary step toward industry rationalization and disaggregation as companies seek critical mass to spin off generation. This suggests that we should monitor the merger process closely, but not try to predict or dictate the path of industry restructuring. Similarly, Central and South West says that the nearly 150 control areas and the utilities that operate them will not survive competitive restructuring and that mergers may allow market forces to bring about a competitive and workable market structure. UtiliCorp notes that mergers and acquisitions are likely to increase as utilities act to improve their ability to compete in increasingly competitive markets. Some of these commenters argue for automatic approval of a merger if no harm to the public interest is demonstrated. PanEnergy and Hawes and Behrends believe that certain types of mergers are either procompetitive or have no effect on competition and warrant a streamlined approval process.

The Commission also received comments from parties that neither favor nor oppose mergers but suggest a revised approach, for a variety of reasons. For example, NIEP and Diamond and Edwards believe that as markets become more competitive and the Commission reduces some aspects of its regulatory scrutiny merger standards should be adjusted so that they more closely

92/ East Texas Coop, Joint Consumer Advoc., and TAPS.

93/ These commenters include Texas Utilities, Southern, DOJ, TAPS, TX Com, NARUC, and APPA.

94/ UtiliCorp, PaineWebber, Texas Utilities, Southwestern, and Southern.

track traditional antitrust principles. On the other hand, PA Com and KS Com support a "wait and see" approach. PA Com comments that reevaluating merger policy may be premature at this time because the Open Access Rule is being reviewed by the industry and power pools do not have to file their open access tariffs until December 31, 1996. KS Com believes that the public interest and state and federal review processes will benefit if a consistent view of the appropriate markets and regulatory framework, designed to achieve an efficient and sustainable generation market, is developed before merger evaluation standards.

Project argues that our merger policies must ensure that the market functions under rules that promote environmental quality and economic efficiency; specifically, a policy of sustainability.

B. How to Implement New Policies

We received a few comments on whether to adopt our new policies on a case-by-case basis, through a policy statement, or through a rulemaking. 95/

Commenters also expressed differing views on whether our new policies should be applied to pending mergers. Lubbock urges the Commission evaluate all pending mergers under the new merger standards. Wisconsin Customers recommends, however, that the new merger policy be applied only to mergers filed after the date of issuance of the NOI.

Environmental Action et al. recommends that mergers be prohibited until the Commission's new merger policy is established through a NOPR process. However, if mergers are not prohibited during this period, there should be a moratorium on unconditional approvals; any mergers approval should be conditional and required to conform to the merger final rule.

The Pennsylvania Commission urges the Commission to let

95/ For example, DOJ, East Texas Coop, OH Com, NRECA, and Southwestern Electric suggest a rulemaking as the vehicle to implement the Commission's new merger policy. CINergy advocates a case-by-case approach; APPA suggests a combination of various methods. DOJ suggests that we convene a technical conference immediately to delineate the relevant geographic markets for the electric utility industry for the entire U.S. DOJ says that this would greatly facilitate the Commission's (and DOJ's) review of merger applications and enable the Commission quickly to establish safe harbors or screens for any merger application based upon changes in market concentration for a known geographic market.

competitive wholesale restructuring develop before approving mergers among the members of power pools.

On the other side, Florida and Montaup argue that any new rule resulting from this proceeding should apply only to merger applications filed after the effective date of a final rule. Merger applications filed before that date should be considered under the filing requirements and standards in effect at the time of their filing. EEI and UtiliCorp request that the Commission move quickly to review those merger applications already before it without waiting to develop a new merger policy.

II. Comments Concerning Effect on Competition

A. Defining the Relevant Markets

1. Defining Product Markets

Some commenters emphasize that relevant product markets should be established from the buyer's perspective, that is, in terms of the delivered product. 96/ Such an approach would examine generation and transmission in combination, since neither is of use to a customer by itself. They add that in an open access environment where transmission rates will remain regulated transmission should be viewed as a substitute for local generation, rather than as a separate market. 97/

Commenters suggest that the Commission examine two or more product markets. However, there is little consensus on which markets to consider. For example, Environmental Action et al. suggests existing generation, new generation, transmission, retail aggregation and sales, physical distribution, demand side management services, ancillary services associated with generation transmission and distribution, and fuels. Industrial Consumers suggests firm and non-firm bulk power, short-term capacity, short-term energy, long-term capacity and energy and transmission services. To minimize opportunities for affiliate abuse RUS recommends examining at least markets for generation, transmission, and ancillary services. For applying the Guidelines to the electric power industry, DOJ and FTC suggest that we look at four product markets: short-term energy, intermediate-term energy, long-term capacity, and ancillary services. FTC notes that sales to differently situated customers may constitute separate markets if differential pricing is feasible. APPA proposes similar markets, but suggests considering short-term energy or capacity. EEI proposes a short-

96/ For example, EEI, UtiliCorp, and Centerior.

97/ These include, for instance, EGA, Low-Income Representatives, NIEP, and TAPS.

term energy and capacity market (up to about two years) and a medium-term (two- to five-year) capacity contract market involving capacity and associated energy sales from excess capacity from existing facilities. MO Com suggests focusing on the commodities market (hourly energy from existing generation facilities) and the contracts market (capacity and energy from existing and new generation). NIEP proposes two broad product markets, generation sales and retail sales. Several commenters suggest that the Commission consider ancillary services as a product market. 98/

Other commenters argue that long-term product markets should not be subject to market power analysis. For example, EEI says that the long term capacity market where sales from new capacity compete with long-term contracts for sales from existing capacity should not be subject to the analysis. APPA makes the same argument for long-run sales from new capacity since such capacity represents potential entry. Similarly, UtiliCorp argues that we should disregard the long-run generation product market because of our finding in the Open Access Rule that long-run markets are generally competitive. CINergy believes that open access, the absence of artificial impediments to expansion of generation capacity by existing suppliers, and the prospect of entry into the generation business by new suppliers preclude market power in the long run. However, DOJ questions the presumption that utilities do not have market power over long-run energy and capacity.

Com Ed argues that the Commission should disregard short-term energy markets because these markets involve buyers who are able to make purchases to replace energy otherwise available at a higher cost, such as from the buyer's own installed capacity. The cost of energy from such otherwise available capacity effectively limits the price at which short-term energy is offered.

Several commenters cite the need to consider the temporal characteristics of product markets. For example, Florida and Montaup suggest dividing them into short-term and medium-term markets and further dividing these into various product markets as appropriate to the area. Others 99/ suggest that delivered capacity and energy be analyzed under market conditions during peak and off-peak hours and summer and winter conditions.

As to whether the Commission should examine only the

98/ These include, for example, Industrial Consumers, DOJ, Environmental Action et al., CA Com, CINergy, and UtiliCorp.

99/ E.g., Madison G&E and CINergy.

wholesale market, leaving concerns over retail competition to the states, Southern says yes. Several commenters believe that we should also examine the impact on retail competition. 100/ They suggest that the Commission has both the authority 101/ and the responsibility to examine the impact of mergers on actual or potential retail competition.

2. Defining Geographic Markets

We received a significant response from commenters on various aspects of defining relevant geographic markets. Most of these comments relate to the approaches such as generic versus case-by-case to defining markets, factors that are important to consider in defining markets, and the use of modeling.

DOJ and others 102/ define the relevant geographic market as the area in which the seller operates and to which the purchaser can turn for supplies. They suggest that the best way to determine which suppliers are in the relevant market is to look at the physical location of the generating unit as opposed to disposition of power from the unit. DOJ suggest that we could determine the geographic markets immediately for the electric utility industry for the United States through a rulemaking or technical conference.

Some commenters urge the Commission to recognize the effects of open access on the extent of geographic markets. 103/ For example, the Commission should revise its current two-tier analysis because open access will broaden the relevant geographic market beyond two tiers. EEI suggests that the Commission first define the smallest geographic area (under the trading patterns existing before open access) and then broaden the market as choices available to the purchasers increase under open access.

However, some commenters are skeptical that defining the geographic market to include suppliers two or more tiers away is a wise approach. For example, RUS warns that defining the market too broadly can understate the problems in sparsely populated areas. It argues that the Commission must allow competitors to present evidence that the market is narrower than the first or second tier. TDU Systems question whether suppliers two tiers away can put competitive pressure on the merging utilities. It

100/ These include PP&L, DOJ, and TAPS.

101/ Citing *FPC v. Conway*, 426 U.S. 271 (1976).

102/ E.g., EEI, Wisconsin Customers, APPA, and TX Com.

103/ E.g., Industrial Consumers, RUS, UtiliCorp, EEI, Wisconsin Customers, Texas Utilities, TDU Systems, and CINergy.

explains that a seller two transmission charges away incurs transmission costs of approximately 15 to 20 percent of the product price which is significantly higher than the 5 percent price increase used by the antitrust agencies. Wisconsin Customers argue that the Commission's method of defining the geographic market results in markets that are too large because all first-tier utilities are included, which leads to underestimates of the true market power of the merged entity. RUS emphasizes that the price increase test in the Guidelines is inadequate in an industry emerging from a monopoly situation and in which mega-utilities could rapidly acquire excessive market power.

Other commenters suggest various approaches to defining geographic markets. For example NIEP proposes that Electric Reliability Council areas be used. Many commenters emphasize the importance of the actual behavior of the grid in defining relevant markets. RUS recommends that a separate geographic market for each state be defined for mergers involving utilities or holding companies operating in more than one state. TX Com argues that we must consider the future geographic scope of markets.

MO Com suggests three models of competition in defining relevant markets: the utility, the wholesale and the retail direct access models. The utility model considers utility/non-utility generator competition to meet jurisdictional loads with no retail access. The wholesale model expands the utility model to consider direct access to all wholesale customers, and the retail model expands the wholesale model to reflect direct access to all end-use customers.

Many commenters list factors to consider in defining relevant geographic markets. The most significant factors discussed are transmission constraints and transmission pricing. There is a wide-spread view that we must take account of transmission constraints, particularly because constraints can lead to shifting geographic markets over time and the ability to wield market power in local markets. 104/ For example DOJ, EGA, and TAPS argue that the Commission should give great emphasis to transmission constraints, since they can be exacerbated by mergers and can lead to significant market power in localized areas. Wisconsin PS and Madison G&E note the importance of assessing transmission constraints both alone and together with strategically located generation to give an advantage to a merging entity's own power sales.

104/ Industrial Consumers, FTC, Lubbock, EEI, Wisconsin PS, DOJ, TAPS, NY Com, Environmental Action et al., Southern, TX Com, RUS, Centex, CENergy, UtiliCorp, MO Com, and CENergy all support this view.

CINergy emphasizes that the extent to which transmission constraints are binding is critical for accurately assessing market conditions. It will be necessary to develop market concentration statistics that account for the distribution of capacity beyond a binding constraint and that include only realistically available supplies inside the area bounded by the constraints. MO Com emphasizes the importance of determining whether constraints will prevent alternative suppliers from having access to the customers of the merged utilities. If available transfer capability is reduced as a result of the merger, the merger increases market power. Even if the merger expands transfer capability as the number of alternative generation sources decreases, the increase in transfer capability may be of little value unless it increases access to generation alternatives. MO Com believes that the burden should be on the applicants to show that limits on transfer capability would not allow them to exercise market power. Further, the Commission should require applicants to have sufficient transfer capability available to meet the net import requirements for base-load power that might be requested by current customers.

On the other hand, Southern cautions the Commission against over-emphasizing transmission constraints, noting that isolated or short term constraints should not affect the definition of the relevant geographic market. Constraints should be considered only if they impede wholesale trade. Moreover, Southern questions our authority to order the construction of transmission facilities to alleviate constraints. In assessing the significance of transmission constraints, the Commission should consider the ability of new generation to locate in the region, mitigating the problem; the feasibility of alternative transactions (such as transmission capacity resale or arrangements with brokers) to bypass the constraint; and the possibility that new power sales would simply displace existing sales, reducing the likelihood that the constraint would occur.

Finally, various commenters recognize that constraints depend on time and location, which may make defining the relevant market difficult. 105/ For example, constraints may be affected by line loadings on a system that vary over the course of a day, week or year. As a result, increases in congestion on transmission lines under high load conditions can change the boundaries of the relevant geographic market. EEI makes similar arguments, suggesting that time-differing transmission use patterns lead to similarly differing relevant geographic markets if constraints arise during peak periods. DOJ and TAPS note that constraints are affected by how the transmission system is operated in terms of, for example, dispatch, decisions on which

105/ E.g., DOJ, EGA, Environmental Action et al., TX Com, and TAPS.

utilities to make sales to or purchases from, equipment ratings, maintenance outage scheduling, and decisions concerning equipment sizing and locations. Thus, we should investigate the possibility of operational manipulation of transmission systems that gives merging utilities a competitive advantage.

Environmental Action et al. suggests that the extent of the geographic market may be unclear because transmission constraints are physical or economic barriers to electricity sales in many locations. DOJ and TX Com caution the Commission not to rely too heavily on historical patterns of trade in determining transmission constraints because open access could create very different constraints in the future.

The second factor mentioned by many commenters as significant in defining the geographic market is transmission costs. 106/ For example Madison G&E believes that pancaking of transmission rates can influence the extent of the market; moreover postage stamp rates and distance-sensitive rates will lead to different numbers of competitors. FTC believes that geographic markets defined in terms of distance sensitive rates would correspond to underlying cost conditions more accurately than markets defined in terms of postage stamp pricing. The MO Com proposes that merging utilities be required to specify the market region where they have a strong competitive influence and file a study showing both short- and long run marginal transmission costs for the region. Industrial Consumers notes that transmission costs include stranded costs.

Commenters mention various other factors as important in defining geographic markets. Some note that institutional arrangements can affect the extent of the market. 107/ FTC notes that differences in the degree and sources of geographic competition may arise from temporal distinctions between product markets such as existing transmission and generating obligations.

FTC suggests that computer models of transmission systems be used to simulate the effects of a small, non-transitory price increase imposed by groupings of power suppliers over various alternative geographic areas. This would allow us to determine whether the price increase would be profitable for a hypothetical monopolist and, therefore, which of the areas are relevant

106/ E.g., DOJ, FTC, TAPS, NY Com, TDU Systems, EEI, Industrial Consumers, CInergy Centerior, TDU Systems, MO Com, Madison G&E, and Com Ed. DOJ argues that it is vital that the Commission quickly replace its case-by-case approach to transmission pricing with a general rule to avoid a merger policy that is inconsistent, inefficient, and inequitable.

107/ E.g., EEI, FTC, Industrial Consumers, and Centerior.

geographic markets. FTC also suggests that the Commission consider developing sufficient data and system modeling tools to be able to screen mergers expeditiously examining the likely relevant geographic market under different assumptions about future transmission rates, different projected transmission improvements and different generation siting assumptions. However Madison G&E opposes the use of models. It says that models do not address conditions in the market for delivered capacity and are inherently incapable of taking into account strategic behavior or the potential effectiveness of threats.

Some commenters offer their views on the merits of a generic versus case by-case approach to defining markets. For example, Southern believes that the Commission should perform case-specific analyses in which it weighs the effects of significantly reduced entry barriers and open access. Diamond and Edwards disagree suggesting that this approach is not consistent and that a better approach would be to look at a large area and determine subregions based on trade patterns. Wisconsin Customers warn that using theoretical bases to determine the boundaries of the relevant markets can be misleading because market power can be exercised even on an hourly basis.

B. Determining the Effect on Competition

Many commenters recommend that once the relevant markets have been defined, the Commission determine the effect of a merger on competition by examining market shares, market concentration, and ease of entry.

1. Market Shares

Commenters offer various views on how to measure market shares and how frequently to do so. They generally argue for more frequent calculation of market shares, particularly for energy products.

DOJ suggests that market shares can be assigned based on production sales, or capacity. It favors capacity because electricity is a homogenous product and because the capability of producing can be readily translated into actual sales. FTC suggests, similarly that market shares may reflect either output or capacity. It argues that in homogeneous product markets, capacity is a better measure, while in differentiated product markets, output based measures are usually a better indicator of firms' future competitive significance. The structure of intermediate-and long term markets is reasonably measured by capacity, and the structure of short-term markets is reasonably measured by output if differentiating factors such as reliability and access are important. Madison G&E suggests that market shares for delivered firm capacity be measured by uncommitted capacity, while market shares for energy be measured by the

amount of deliverable energy at competitive prices during the time period in question. EEI suggests examining market shares associated with installed capacity and uncommitted capacity or energy that are excess to the capacity committed to serve native load customers existing contracts, and other obligations. Southern Company believes that excess capacity is a better indicator of a merging entity's ability to exercise market power than is total capacity.

Others also suggest that when calculating market shares, we exclude contractually-obligated capacity; for example, FTC emphasizes that capacity or output that is contractually obligated may not be relevant to calculating market shares of potential suppliers for other customers. For instance, supply that is contractually obligated to local load is unlikely to be a part of the market for short-term capacity. Similarly, Southern Company claims that capacity committed to serve native load, wholesale requirements service, or sales outside the relevant market should not be considered.

As to the frequency with which market shares should be calculated, several commenters note that generation dominance can create anticompetitive effects in localized markets during certain times (daily, seasonally) due to transmission constraints. Madison G&E would calculate market shares beginning with the year in which the merger is expected to be consummated and several years into the future. It believes that market shares for energy should be calculated for peak and off-peak periods. Similarly CInergy proposes examining market conditions monthly for energy markets to address problems of market power in particular periods.

As a final word of caution, DOJ states that not all market shares are equal. For example, a utility may possess market power that is disproportionate to its market share if the marginal costs of that utility's generators are closest to the market-clearing price for electricity in that market.

2. Measuring Market Concentration

There is wide support among the commenters for using HHI analysis to measure concentration in relevant markets but many suggest modifications. For example EEI suggests that considerable judgment is needed to arrive at the combination of HHIs that best reflects an appropriate structural analysis of market power. If several suppliers have enough excess capacity to meet anticipated incremental market requirements the Commission can treat each as having an equal contribution to market concentration. EGA suggests that we consider reasonably predictable effects of recent or ongoing changes in market conditions, such as the creation of ISOs, in interpreting market concentration and market share data.

Several commenters suggest that HHI analysis be used as a "screen" for market power to create some sort of "safe harbor" allowing mergers to be quickly approved if they meet certain tests 108/ For example, Southern Company believes that the Commission should establish threshold HHI levels that would be safe harbors in the merger review process. It contends that increases in market concentration resulting from mergers often do not pose a significant threat to competition and that mergers are a means by which industries and individual firms adjust to market change to maximize efficiency and consumer welfare. Similarly, Uti iCorp endorses HHI screens, but suggests that we consider the transitional circumstances of the electric utility industry in designing the screens. The Commission should analyze the effects of the merger under criteria similar to those contained in the Guidelines if the merger does not pass the screen.

EI and APPA argue that the Commission need not be concerned about mergers with a post-merger HHI at or below 2000 (that is, five equal sized firms). However, EI emphasizes that selection of a particular threshold value is based upon judgment, not science. The Commission may want to consider specifying more refined thresholds based on experience in wholesale power markets. Precise numerical HHI thresholds are less important than how these thresholds are used, that is, as screening devices to distinguish mergers that are clearly benign from those requiring further scrutiny. The Commission should be mindful that HHI analyses are based on historical data and that changing regulation and market developments that increase competition may allow the use of higher HHI thresholds or a more liberal interpretation of results. On the other hand, Central and South West proposes that where HHI values are up to 2500 there should be a rebuttable presumption that the region is workably competitive. It believes that the market will eventually encompass all synchronously connected regions under the Commission's jurisdiction.

Some commenters caution against putting too much emphasis on HHI analysis, suggesting that the Commission look at additional factors 109/ For example, Wisconsin PSC asserts that HHIs (incorporating transmission constraints) can be used as a screen but should not substitute for the Commission identifying potential discriminatory practices in areas such as maintenance, planning, system modeling, equipment ratings, system design, operation control, and use of generation, all of which Wisconsin PSC asserts affect transmission constraints.

108/ This "safe harbor"-type issue is discussed further below under "Procedures for Handling Merger Cases."

109/ E.g., East Texas Coop and Wisconsin PSC.

Other commenters suggest standards other than HHI analysis for determining if market power would result from a merger 110/ Some would require having at least five reasonably comparable suppliers, no single dominant supplier and reasonably free entry to all segments of the relevant market. Diamond and Edwards opposes this view, stating that the number of firms and level of competition are only loosely related; competition can be intense with only two firms or nonexistent with many firms. It suggests that the Commission entertain the possibility that in the intermediate term, competition among the few (such as between regions), with appropriate market power mitigation measures such as ISOs, retail access, or divestiture, may be necessary as the industry moves toward "workable competition."

NIEP argues that a merger should be presumed to be anti-competitive if the merged entity would have a 20 percent market share based on either generation sales or retail sales within a reliability council area Com Ed disagrees contending that for an undifferentiated product like electric power the Guidelines suggest a higher figure of 35 percent. NIEP further argues that mergers not presumptively anticompetitive would still be scrutinized on the basis of whether the merged firm could sustain a 5 percent price increase.

Centerior and Com Ed oppose HHI analysis. Centerior believes that HHI measures are inadequate to measure market dominance. Rather an assessment of market power should be based on the number and characteristics of a customer's options. For example if a customer could look at several generation options and combine them with available transmission, so that there are several delivered power options, a proposed merger should be acceptable Centerior notes that EEI's criteria do not account for the potential loss of native load customers, which could create excess capacity that, under HHI analysis, could lead to a finding of market power. An adequate market power screen could be based on regional concentration of competing utilities in the relevant market and/or market shares, as proposed by EEI.

Com Ed objects to any market concentration ratio for energy or even capacity markets based on a capacity measure because the capacity that utilities have available to make economy energy sales fluctuates constantly, depending on system conditions. Only generating units operating on the margin are capable of conferring any degree of market power, and identification of those units requires a rigorous analysis of the mix of generating units controlled by all utilities who could participate in the market. This leads Com Ed to conclude that generating capacity is not a meaningful indicator of market power in the markets for

110/ For example, IN Com, Industrial Consumers, and Environmental Action et al.

either capacity or energy. As an alternative to looking at market concentration ratios, Com Ed suggests that we review actual competitive conditions and assess the potential for anticompetitive behavior by determining whether there are feasible market manipulation mechanisms that are likely to succeed. Com Ed argues that for the Commission must recognize as a competitive issue the likely effects of a proposed merger on the operations and costs of neighboring utility systems, including effects on the loadings of their transmission systems. EGA shares a similar view, specifically recommending that the Commission focus on whether the merger will increase the transmission costs of potential competitors.

3. Ease of Entry

The Commission received a number of comments on considering the possibility of entry by new competitors in assessing market power. These comments address both the types of entry barriers that might exist in the industry and the importance of entry analysis.

Commenters suggest that there are various barriers to entry in this industry 111/ These include existing law and regulation and economic incentives created by a utility's role as monopolist and competitor regulatory approval requirements the amount of time it takes to move from planning to operation of new facilities the existence of excess capacity in the relevant market economies of scale and capital requirements; favorable location and access to raw materials and access to distribution channels (including access to transfer capability of the transmission system and pancaked transmission pricing).

Some commenters believe that entry is a critical factor in merger analysis. For example, Joint Consumer Advoc and TAPS argue that careful analysis will indicate significant barriers to entry. TAPS notes that measures of market dominance such as concentration indicate whether a utility currently can dictate price levels, while analysis of barriers to entry indicates whether a utility can foreclose competition prospectively. NY Com urges the Commission to focus its analysis of barriers to entry on factors such as transmission power flow analyses availability of generation plants, reserve margins, load pocket constraints, and system stability.

Several commenters are skeptical that entry analysis, as done in the Guidelines, makes sense for the electric utility industry; they argue that entry will not mitigate market power. For example, Industrial Consumers notes that the Guidelines

111/ These commenters include, e.g., Environment Action et al., FTC, Madison G&E, MO Com, IN Com, and NY Com.

recognize that market power can be defeated if entry is "easy," that is, timely, likely and sufficient to deter or counteract the anticompetitive effects. However Industrial Consumers believes that entry into the transmission and distribution business is not easy nor accomplishable in two years -- given the nature of monopoly franchises, obstacles to siting, and "need justification" standard for regulatory approval. Stranded cost recovery also raises a significant barrier to entry by a new participant into the market, even under open access.

DOJ notes that market entry is not likely to mitigate the anticompetitive effects of a merger when there is chronic excess capacity because a new entrant would have to recover both operating and fixed costs, while the merged entity would need to recover only operating costs until excess supply is eliminated. PTC doubts that entry is significant for most electric power merger cases because it may take more than two years to complete new generation and transmission facilities (due to lags in regulatory approvals and construction). These forms of entry are unlikely to respond to an anticompetitive merger in time to deter or constrain the exercise of market power. APPA also believes that potential entry is not an effective restraint where existing capacity is concentrated.

On the other hand, CINergy suggests that even in the short run, pricing behavior can be constrained by potential entry because customers can make long-term commitments to purchase from developers of new generation resources and incumbent suppliers will account for potential long-term load losses in setting their prices in the short run. Southern Company argues that with open access, entry is now easy.

4. Factors Affecting the Market Analysis That Can Change Over Time

There is substantial support among the commenters for the use of dynamic standards at least to some degree, rather than static standards that may become obsolete as competitive energy markets develop. Some 112/ recommend that we consider both immediate and long-range effects of mergers. Others 113/ believe that any anticompetitive consequences should be evaluated not only in the context of the industry as it is structured today (vertically-integrated utilities serving both at wholesale and retail), but also as to how the industry may evolve. UtiliCorp argues that we should also consider the current state of transition in the industry when we examine merger applications that do not satisfy the market concentration and competition

112/ E.g., Lubbock and Low-Income Representatives.

113/ E.g., Com Ed and CINergy.

screen. It notes that requirements contracts currently in effect impede competition, but will cause the potential anticompetitive effects of mergers to be exaggerated because more alternatives will be available when the contracts expire.

Most commenters argue that, although open access may enlarge geographic markets and lower entry barriers we should not expect that market power problems will disappear so that merger analysis will not be needed in the future. They believe that factors such as transmission constraints and lack of true comparability in the use of open access tariffs will continue to warrant market power and merger analysis. 114/

UtiliCorp recommends that the Commission consider the contingencies of retail competition and restructuring as we analyze the future impacts on competition of market concentration, market power and mergers. Southern Company contends that the Commission should not consider retail competition issues because state regulators are effective watchdogs who protect the interests of retail customers and assess the impact of mergers on competition in retail markets.

Wisconsin PS argues that opening retail markets to competition will result in substantial uncommitted capacity on the systems of merging utilities and will put pressure on them to market capacity through a more intense use of their transmission systems. Centenor suggests that the market analysis may need to consider the effect of competition policies promulgated by the state at the retail level in the future. Excess capacity may increase if retail customers get the right to select a new supplier based solely on lower rates. Therefore, a utility that did not have market power in the past may find that it has increased excess capacity and may thus acquire market power.

CINergy suggests that restructuring should be considered in the review of mergers only if there is a plan already approved by the state regulator with a set implementation schedule beginning within three years of the consummation of the proposed merger. Future potential changes in the basic structure or regulation of the industry should be addressed by exercising the continuing authority to supplement merger orders under section 203(b), including the possibility of requiring divestiture.

5. Consideration of the Separate Effects of a Merger of Transmission and Distribution Facilities

A horizontal merger of vertically integrated utilities can be viewed as a generation merger, a transmission merger, and a distribution merger. A merger of transmission-owning utilities

114/ E.g., FTC, East Texas Coop, and Industrial Consumers.

may have various effects on the grid, such as better planning, coordination, fewer pancaked rates, and strategic control of regional transmission grids. NIEP urges the Commission to recognize that mergers of entities that own only transmission should not raise substantial competitive concerns if the transmission is operated by an ISO. CA Com and DOJ intimate that mergers may occur in order to avoid pancaked rates. CA Com recommends that the Commission use the open access tariffs to remove the anticompetitive factor of pancaking and thus make mergers less attractive.

Several commenters address the effects of mergers at the distribution level. 115/ Some argue that the consolidation of distribution assets and the creation of large retail monopsonists are competitive concerns that we should address. IN Com believes that physical and economic interactions blur the distinction between the wholesale and retail sectors requiring that the effects on the retail market be considered to analyze the merger implications in the wholesale market. It would reject a merger that has negative retail effects even if the merger has positive effects in the wholesale market.

Other commenters fault the Commission for disregarding market power in the distribution sector of the industry. They suggest that mergers are likely to increase barriers to entry into the distribution market and monopsony power over sellers of generation 116/ As larger distribution systems are created through mergers smaller independent generators may be disadvantaged because they lack the resources required to meet thousand-megawatt solicitations with complicated delivery requirements. Environmental Action et al. also contends that the larger distribution systems created by vertical mergers heighten the opportunity for anticompetitive self-dealing between the distribution and generation arms and diminish the prospect for effective retail competition.

6. Vertical Mergers

Com Ed suggests that, in the future, vertical or conglomerate mergers rather than horizontal mergers may offer strategic opportunities to utilities. It recommends that our merger policy be flexible enough to deal with differences in the concerns raised by such mergers and horizontal mergers.

7. Application to Electric Power Purchases

A few commenters raised the issue of monopsony power

115/ E.g., CCEM and NIEP.

116/ E.g., Joint Consumer Advoc, Environmental Action et al.

stemming from mergers. Joint Consumer Advoc. points out that a utility may exercise monopsony power over sellers of generation, obtaining power at a lower price than its competitors.

8. Linked Consideration of Contemporaneous Mergers
That Have Interdependent Market Effects

Several commenters argue that the Commission should consider such mergers on a cumulative basis. 117/ Some argue that one merger may alter the boundaries of the relevant geographic market in which the other merger occurs; that is, transmission constraints in one market may be altered by new economy energy transactions associated with a merger in a neighboring market. APPA suggests consolidating contemporaneous proceedings that have interdependent market effects. Colorado Municipals notes that regulating the cumulative effect of contemporaneous mergers may be difficult.

117/ E.g., APPA, NRECA, Enviromental Action et al., Joint Consumer Advoc., and Colorado Municipals.

III. Comments Concerning the Effect on Costs and Rates Factor

A. General Comments

Many commenters consider the effect on costs and rates to be a critical factor in deciding whether to approve a merger. 118/ In fact DOJ notes that the Guidelines recognize that some otherwise anticompetitive mergers may be justifiable because they produce important net efficiencies that, on balance, benefit competition and consumers (for example, through rate decreases).

However, commenters supporting this approach differ on how the costs and rates standard should be applied in cases where competitive harm is shown. For example, TDU Systems suggests that when a merger lessens competition, the Commission should not give substantial weight to cost savings and other benefits that could be achieved absent the merger. Moreover the burden should be on the applicants to show that benefits not attainable without the merger outweigh the harm. IN Com recommends that applicants be required to show a low probability of harm to competition and to show significant quantifiable net benefits to consumers. CINergy believes that the consideration of benefits should be limited to ratepayer protection and that applicants should be allowed to make an affirmative showing that such benefits will flow back to the ratepayers.

Other commenters argue that the costs and rates factor should be abandoned. For instance, Com Ed suggests that analysis of costs and rates has no place in an emerging competitive arena as long as mergers do not harm the competitive market, because prices will be set by market forces and customers can choose their suppliers based on price. Southwestern PS supports this view, arguing that most regulatory cost and rate issues that remain relevant are retail-related and under state jurisdiction; the Commission should defer to state commissions on such matters.

Others state that the analysis of the effect of the merger on rates is one of the most costly components of a merger analysis. 119/ They assert that in a competitive environment, there will be little need for the Commission to speculate about future costs, as utility managers will be reluctant to enter into mergers that would increase costs.

BBI argues that elimination of the costs and rates analysis would substantially reduce the time to prepare a merger application and the Commission's time to process it. Although

118/ E.g., CINergy, TDU Systems, IN Com, DOJ, and Centerior.

119/ E.g., CINergy, PaineWebber.

merger efficiencies can be substantial, their measurement and allocation serve a limited purpose in the Commission's analysis. Merger applicants should not be required (but can volunteer) to demonstrate merger efficiencies as part of a filing.

B. Determining the Net Benefits

We received a variety of comments on how to determine the benefits of a merger the costs of the merger, and the degree to which one offsets the other. Many parties stress the importance of rate reductions. 120/ International Brotherhood contends that in an era when customers should be able to anticipate rate reductions from competition rate freezes are not sufficient. Com Ed agrees that consideration of cost and rate impacts may still be appropriate for segments of the industry that are not competitive transmission and distribution) The KS Com asserts that cost savings from combining the merging companies' stand alone transmission and distribution systems should be evaluated and that we should require assurances that efficient transactions cannot be arbitrarily discouraged in favor of the merged entity. Some contend that we should look at the effect of a merger on the costs and rates of competitors; however, they admit that this may be another way of assessing the effect of the merger on competition.

Many commenters 121/ assert that no weight should be given to efficiencies and benefits that can be obtained by means other than the merger. CA Com suggests that formation of ISOs may provide many of the transmission operational and efficiency benefits typically claimed by merger applicants. Others suggest that the Open Access Rule will facilitate coordination among utilities so that in some cases mergers will not be required to achieve economies. 122/ Some argue that we should refuse to count as a merger benefit the substitution of efficient practices for inefficient practices that could be achieved without a merger. 123/ Personnel reductions may be one example as many businesses are downsizing without merging. OK Com contends that many of the efficiencies proposed to be passed along to customers through lower rates may actually reflect unavoidable cost reductions forced upon the merging utilities by competition.

However, Southern Company cautions that, in assessing what

120/ E.g., NV Com, NRECA, Joint Consumer Advoc., and TX Com.

121/ Including APPA, EA & CF of A, IN Com, East Texas Coop, Otter Tail, and Industrial Consumers.

122/ E.g., Environmental Action et al., IN Com.

123/ E.g., Industrial Consumers and Environmental Action et al.

merger savings could be achieved through coordination without a merger, the Commission must consider section 1 of the Sherman Act, which prohibits certain joint actions as anticompetitive and restricts the sharing of information between competitors. What appear to be benefits achievable outside the merger may only be achievable if the companies illegally collude.

NY Com proposes that, instead of relying on claimed merger benefits related to scale economies the Commission should look at the results of the merger how the merger will affect price, ease of competitive entry and quality of service for example closings of customer service centers). Environmental Action et. al. believes that, in comparing costs and benefits the acquisition cost and its rate treatment should be considered; it suggests that the Commission reject a merger if the merged company intends to seek recovery of the acquisition premium from captive customers. OK Com is concerned that mergers may require utilities to incur costs such as construction of transmission lines to meet the integration requirement.

Some commenters contend that the Commission should not count claimed savings if the applicants are not willing to bear the risk of not achieving the savings. 124/ They say that the level of claimed savings is typically insignificant compared to total company costs. Industrial Consumers argues that the concept of savings from "deferral" of capacity is meaningless.

With respect to how net benefits of a merger should be calculated some commenters maintain that claimed savings should be discounted to present value as cost savings tomorrow are worth less than cost savings today. 125/ RUS recommends that the Commission calculate the "revenues gained" by the prospective merged entity adapted from the revenues lost approach set forth in Open Access Rule for determining stranded cost exposure on a net present value basis. 126/

Several commenters contend that the savings claimed for previously approved mergers did not materialize. They urge the Commission to scrutinize claimed savings more carefully. 127/

Low-Income Representatives recommends that the Commission

124/ E.g., Joint Consumer Advoc., TX Com, and Environmental Action et al.

125/ Industrial Consumers, East Texas Coop, and RUS.

126/ Open Access Rule, 61 Fed. Reg. at 21,662.

127/ Joint Consumer Advoc., TX Com, Industrial Consumers, and NRECA.

carefully scrutinize claimed savings to ensure that cost reduction does not mean service or quality reduction. Environmental Action et al. notes that despite the vigorous efforts made by merging companies to win merger approvals with promises of rate reductions little time is spent in Commission proceedings reviewing the effects on rates. It believes that more scrutiny on rates in the merger proceeding will establish more clearly, before final commitments are made, who is bearing what risk. It also explains that there are good reasons to be skeptical about savings from a proposed consolidation of generating assets because studies suggest that unit scale economies are reached at 400 MW and multi-unit plant economies at 1600 MW. Similarly NRRI states that for the majority of firms in the industry, average costs would not be reduced through the expansion of generation, numbers of customers, or the delivery system.

C. Allocation of Benefits and Costs

Several commenters raise the issue of how net benefits should be allocated between investors and customers. East Texas Coop says that net benefits should not include any part of the benefits allocated to shareholders; benefits not allocated to ratepayers cannot be claimed as a benefit to the public interest. APPA and NRECA want the Commission to develop standards for allocating cost savings and other benefits among customers ratepayers, and shareholders. NY Com further proposes that requiring merger applicants to share claimed savings between customers and shareholders would discourage utilities from overstating the claimed benefits of a merger.

Some commenters argue that an acquisition premium is a cost of the merger that should not be recoverable from ratepayers if it would lead to an increase in rates. 128/ NY Com contends that allowing recovery of such premiums from ratepayers may inflate purchase prices and result in exaggerated claims of merger savings to increase chances of approval, rewarding the purchaser. OK Com would give rate consideration to an acquisition adjustment for mergers determined to be consistent with the public interest, and says that states should have a role in defining the public interest. Environmental Action et al. would prohibit the merger if the merged utility has a retail sales monopoly and the state does not have a policy of excluding the acquisition premium from retail rates.

Environmental Action et al. also believes that the proper cost allocation arrangement for a merging company, where the customer groups have different cost histories associated with different assets, is to have the price charged by the seller in

128/ E.g., Joint Consumer Advoc. and NY Com.

inter-affiliate transactions be a market price. In this manner, the "buying" customers will take the power only if it is the best price on the market, and the "selling" customers will receive a reward commensurate with their risk. If the merging companies cannot, under this treatment, come up with sufficient benefits to satisfy the acquired company, the merger does not meet market standards and should not be approved. Environmental Action et al. claims that any other approach makes the acquiring company's ratepayers unwilling donors to the financial success of an expansion strategy.

IV. Comments Concerning the Effect on Regulation Factor

Most commenters agree that regulatory impact continues to be relevant and important. EEI argues that mergers could affect regulatory effectiveness either through impacts arising from the transfer of authority from one regulatory jurisdiction to another or problems associated with cost allocation. EE notes that merger does not change the Commission's authority over transmission in interstate commerce and sales for resale nor state commission authority over retail rates. Neither does merger affect the Commission's ongoing jurisdiction to determine cost allocation and to specify proper accounting treatment of cost allocations generically.

Several commenters stress that mergers resulting in multi-jurisdiction utilities and creating possible federal preemption deserve special attention. 129/ OK Com also argues that regional regulatory bodies may be necessary in the future and is concerned that mergers can interfere with their effectiveness and formation.

CINergy dismisses the relevance of the effect on regulation, given that the Commission has held that a transfer of jurisdiction from one regulatory body to another in no way implies that regulation will be any less effective. 130/ CINergy agrees with the Commission's holding and suggest that the regulatory effectiveness criteria be eliminated.

Others commenters stress the importance of this factor, but link it to other factors. Southern Company recommends that analysis of this factor should be subsumed within analysis of the merger's impact on costs and rates. APPA believes that the analysis of the merger's impacts on regulation should be linked to a requirement that merger produce affirmative public benefits,

129/ NV Com, WI Com and NRECA.

130/ Entergy Services, Inc. and Gulf States Utilities Company, 62 FERC 61,073 at 61,373-74, order on reh'g, 64 FERC 61,001 (1993), appeal pending, 94-1414 (D.C. Cir).

including structural changes that enhance competition and reduce the need for regulation. It also argues that the Commission should give deference to state action when assessing the impact on state regulation, although the Commission must make the final call on this factor.

V. Comments Concerning the Other Commonwealth Factors

The other Commonwealth factors are evidence of coercion, the proposed accounting treatment and the reasonableness of the purchase price. These factors elicited very little comment. As to evidence of coercion, a few commenters suggest that this should be evaluated by the marketplace rather than by the regulatory process. 131/ Several commenters say that this factor should only be considered if someone demonstrates that it is relevant. 132/ OK Com is among very few commenters who favor the retention of coercion as a criterion. It suggests that coercion is a means by which some companies try to gain oligopolistic control of the market in the coming competitive environment.

As to the accounting treatment, some commenters support elimination of accounting concerns as a factor. 133/ PaineWebber notes that most recent mergers were mergers of equals, involving minimal premiums over current market prices. It suggests that a similar market discipline would likely cause shareholders to reject merger transactions involving large merger premiums and excessive amortization. Florida and Montaup argue that the accounting treatment of a merger should not be an issue for hearing unless an applicant seeks treatment different from the Commission's standards. Southern Company contends that the Commission's analysis of this factor should be subsumed within the analysis of the merger's impact on costs and rates.

NY Com and OK Com are concerned about the accounting consequences of mergers. OK Com avors retention of the historical cost approach to account ng for plant acquis tions during mergers and business combinations until competitive market structures are achieved at the national, regional and state levels. NY Com also urges the Commission to continue to require unrestricted access to all books and records of newly merged entities.

131/ East Texas Coop., BEI, PaineWebber, and Southern.

132/ Florida and Montaup.

133/ East Texas Coop., BEI, and PaineWebber. Although they do not support keeping this factor, BEI and PaineWebber suggest that in light of broad industry changes, this may be the right time for a generic re-examination of accounting concerns, of which accounting for mergers could be a part.

We also received a few comments on looking at the reasonableness of the purchase price as a factor. A number of commenters 134/ urge that the Commission should not substitute its judgment for that of market forces, which will determine the reasonableness of the purchase price. Others 135/ believe this issue should be examined only if its relevance is raised. However, OK Com argues that purchase price retains some relevance in this era of diversification. It is concerned that the purchase price may be based on expected returns on non-regulated investments, which, if they fail to materialize, may dilute utility stock.

VI. Procedures for Handling Merger Cases

A. Comments Concerning Filing Requirements

Some commenters 136/ urge the Commission not only to spell out the precise standards it will use to review merger applications, but also to establish understandable filing requirements that clearly identify the necessary information on the effects of the proposed merger on competition and on rates. East Texas Coop says that having more substantive filing requirements and early access to computer studies and simulations would benefit all parties and the Commission. Low-Income Representatives believes that a merger applicant should be required to show that there is workable competition for each customer class in any market in which it participates. NY Com proposes that the Commission require merger applicants to submit estimates of the price elasticity of both supply and demand in the relevant markets and an analysis of entry barriers to new supply. Southern Company advocates the adoption of filing requirements designed to support use of the Guidelines, as modified for the electric power industry.

Commenters also recommend that the Commission adopt new filing requirements to enhance and expedite our analysis of the rate impacts of merger applications. Florida and Montaup argue that the Commission should set out filing requirements related to merger cost and savings which would have to be met only if the applicants claim that the merger results in consumer savings. International Brotherhood asks the Commission to require merger applicants to file an economic impact statement analyzing the effect of the proposed savings (many achieved through layoffs) on the economy of the communities served.

134/ CINergy, East Texas Coop, EEI, PaineWebber, and Southern.

135/ Florida and Montaup.

136/ Missouri Basin, NIEP, Centerior, Florida and Montaup, APPA, and Southern.

Project proposes that the Commission require merger applicants to include an assessment of the environmental and related economic impacts of the planning and operational changes that are expected to result from the merger. The required information would include changes in dispatch, resource planning procedures and resource acquisition plans; changes in emissions of SO₂, NO_x, CO₂ and particulates and changes in resources devoted to research and development, DSM programs, and renewable technology investments.

Many utility commenters want a faster merger consideration process. 137/ Some claim that delays in processing merger applications harm the public interest in various ways: utilities lose the ability to respond to market forces quickly (thereby retarding procompetitive restructuring efforts benefits to consumers are postponed investors experience uncertainty (creating problems in capital markets and the efficient flow of capital); utility employees lose productivity as doubts linger about their future roles; and the public loses confidence in the regulatory process. Some commenters argue that we could act faster if we looked at any one or two of the Commonwealth factors. 138/

Com Ed believes that in the coming competitive marketplace, it will be important for the Commission not to allow the merger approval process to become captive to intervenors who allegedly are often seeking merely to gain a competitive advantage through delay. Noting that the DOJ and FTC initial review process can be completed within 30 days, Com Ed and others question why the Commission's review needs to take significantly longer.

Some commenters ask for faster merger consideration for certain types of mergers, 139/ particularly for uncontested applications mergers between a utility and a non-utility firm; mergers between affiliates; and mergers between small, non-dominant utilities. Haves and Brehrenda also advocate expedited treatment for a disaggregation (an internal disaggregation within a holding company a spin-off to shareholders, and a disaggregation coupled with a merger); a merger of a jurisdictional electric utility with a gas utility; a combination of non-interconnected electric utilities; and a merger of a jurisdictional utility with a company that is not an electric utility, even if the latter owns a power marketer.

137/ E.g., Texas Utilities, Southwestern PS, Sierra Pacific, Southern Company, UtiliCorp, and EEI.

138/ E.g., Southwestern, Southern, and PS Colorado.

139/ UtiliCorp, PaineWebber, PanEnergy, Com Ed, Centerior, Southern, APPA, NRECA.

Some utility commenters 140/ recommend that we identify specific time frames or themselves suggest time frames for the Commission either to rule on the application or to request further information. Florida and Montaup argue that we should not routinely set all merger cases for hearing. The Commission should use procedures that would allow intervenors to conduct voluntary discovery before an application is set for full hearing and refer the proceeding to an Administrative Law Judge (ALJ) for the limited purpose of resolving discovery issues. Another suggestion is that we streamline discovery and coordinate the activities of parties with similar positions during the hearing and the briefing phases of cases set for hearing by working the ALJ. 141/

On the other hand, some commenters argues that mergers that create large utilities are being processed too quickly. 142/ They say that intervenors do not have time to obtain information and develop a case. Some of these commenters urge the Commission to lengthen the time period for interventions in merger proceedings, and to permit intervenors to conduct discovery during this period. East Texas Coop also requests that the Commission not allow answers to protests and not allow merger applicants to have a formal right to "the last word."

APPA and East Texas Coop both oppose the adoption of strict time schedules for Commission action. Many commenters urge the Commission not to approve a merger before it can assess adequately the effects of increased concentration in the industry.

140/ E.g., Sierra Pacific, UtiliCorp, MidAmerican, and PP&L.

141/ PP&L.

142/ E.g., International Brotherhood, Joint Consumer Advoc., East Texas Coop, and Enviromental Action et al.

B. Safe Harbor Suggestions

DOJ and EGA urge the Commission to "refine and sharpen" the focus of its merger review analysis so that mergers are processed more efficiently, with desirable mergers receiving swift approval, while undesirable mergers are set for hearing.

Other commenters 143/ suggest that we use a two-stage process allowing a merger passing a safe harbor test to be approved quickly. EEI proposes detailed regulations covering pre filing consultation, initial filing requirements, a two-step review process based on an initial market power screen (consisting of an initial filing and an initial finding order), the hearing process, appeal, and interests to be balanced by the proposed regulations.

Commenters generally suggest that the first stage analysis be simple with basic filing requirements and, if the applicants pass certain merger screens, approval would be automatic or quick perhaps with a paper hearing. Applications that do not pass the merger screen would face additional more detailed filing requirements and a more in-depth second stage analysis, probably with a trial-type hearing. Some would allow ample opportunity to settle, however, and so avoid a lengthy hearing.

EEI urges that if a merger does not pass the initial merger review screen, it should not be rejected; rather, this merely indicates that the Commission needs to consider other evidence regarding the merger's impact on the competitive market.

East Texas Coop's two-stage procedure has a slight variation: the opportunity for an intervenor to show that a proposed merger will result in the strategic control of transmission assets, even if the merger application passes the Commission's stage-one screens.

Some commenters 144/ propose that if the safe harbor screens are satisfied, the merger should be approved automatically, either by the Commission's staff under delegated authority or under a "limited review" procedure. Under the limited review" procedure the case would be referred to an ALJ with a short time schedule to render a decision, after which approval would be granted by staff through delegated authority unless the ALJ or staff determines that the issue should be considered by the Commission. PanEnergy also argues that an unopposed merger should be approved by delegated authority without a hearing.

143/ E.g., Texas Utilities, Southern, EGA, DOJ, CInergy, East Texas Coop, and NRECA.

144/ E.g., Hawes and Behrends.

Various factors were suggested for setting the screens. Commenters suggest that the Commission consider the merged company's absolute size, its market share, its ownership or control of transmission, its affiliation with suppliers of competing forms of energy such as natural gas) absolute market concentration, the effect of the merger on market concentration, whether a small group of firms could act in a collusive or coordinated manner whether the acquisition is by a new entrant, and the existence of barriers to entry in the wholesale generation market in which the merged entity would participate, among other factors.

A number of commenters 145/ recommend that the Commission use market concentration screens similar to those adopted by DOJ and FTC. With regard to the HHI screen used in the Guidelines, DOJ uses two HHI screens for a horizontal merger: (1) the increase in the HHI caused by the merger and (2) the post-merger HHI. The Guidelines indicate that a merger falls within a safe harbor if the post-merger HHI for the relevant market is no higher than 1,000 or the increase in the HHI is no more than 50. (The HHI approaches 0 if there is a large number of small competitors, and is 10,000 if there is just one firm.) APPA would screen from full analysis any merger for which the market's post-merger HHI is less than 1000.

Other commenters 146/ oppose a safe harbor or two-stage screening process to expedite merger approval. Some argue that this proposal would not give the Commission enough time to closely scrutinize the effects of the merger on such important factors as barriers to entry and short-term monopoly rates. PP&L argues that the Commission should not use merger screens until it has more experience with analyzing mergers in a more competitive electric market.

C. Coordination With Other Agencies

Many commenters say that the Commission should coordinate its consideration with that of other state or federal agencies. The New York Commission calls for improved coordination between the Commission and the states in order to give the industry clear regulatory guidance on the treatment of mergers during the transition to competition. NARUC, CA Com, and IN Com suggest several alternative coordination options. Commenters offered the following specific proposals on how the Commission could coordinate better its merger review with those of the states.

First, several commenters support having a "scheduling

145/ E.g., Utilicorp.

146/ E.g., PP&L, Joint Consumer Advoc.

conference" with the Commission and all state regulatory agencies. NARUC suggests that, when the Commission receives a merger application we should convene a scheduling conference with representatives of the relevant state commissions to coordinate the schedules for the federal and state reviews of the merger applications. Such an arrangement would permit each agency to consider the merger proposal fully while also providing state regulators with the means of conveying their views to the Commission. Sierra Pacific urges us to rely more frequently on joint conferences with state regulators. 147/ Such an approach would expedite the processing of mergers, limit unnecessary duplication of procedures, and produce more uniform federal-state results.

Second, several commenters recommend that the Commission let state regulatory commissions complete their review and then comment in the Commission's proceeding. 148/ NARUC and others observe 149/ that during the state proceeding state regulators cannot take a position in a Commission proceeding without prejudging the outcome of the state proceeding. They ask that the Commission defer its decision until after state proceedings have been concluded, or that we give states a reasonable opportunity to conclude their proceedings before they must file testimony here. Similarly, APPA argues that the Commission should give deference under FPA section 201(b) to state determinations by adapting our procedures to allow states to intervene after state review is completed. The Commission could distinguish between two kinds of state intervenors: state consumer advocates or executive branch representatives, who must meet the same intervention requirements as do other parties; and state commissions acting in parallel on the same merger application, who would file later.

Third, a number of commenters say that there should be some joint federal-state vehicle to coordinate merger consideration with state regulators, such as a joint filing requirement, a joint record, or a joint proceeding. 150/ Environmental Action et al. suggests that a merger application should be filed as one document with the Commission and relevant state regulatory commissions at the same time. PP&L asks that we require any state applications to be filed simultaneously with and attached to the Commission application. NARUC suggests that a joint

147/ Citing Subpart M of our Rules of Practice and Procedure (sections 1301, et seq.)

148/ E.g., NARUC, APPA, KS Com, Environmental Action et al.

149/ KS Com, Environmental Action et al.

150/ NARUC and Sierra Pacific.

record be developed by the Commission and the states. It also suggests that the Commission consider a joint proceeding. However, PP&L opposes this, arguing that because state commission issues and procedures might differ considerably from those before the Commission, joint or concurrent hearings probably would not save any resources and could complicate the hearing process. Accordingly PP&L argues that we should continue to process mergers separately from the states.

Fourth, some parties say that the Commission should defer to state commissions on certain matters. Some argue for deference regarding a merger's effect on retail costs and rates. 151/ PaineWebber argues that the responsibility for determining the effects of a merger on retail customers is not subject to this Commission's review. NARUC, however, says that both state and federal regulatory agencies should evaluate a merger's effect on rates, as well as on generation competition and on access to transmission facilities. Similarly, some parties argue that the Commission should generally defer to state commissions regarding the impact of mergers on competition in retail markets. 152/

Another suggestion is raised by the Ohio PUC, which proposes a specific new process for federal-state coordination of merger consideration. The purpose is to analyze market power in unbundled electric service markets, with the Commission assessing the merger's effect on transmission market power and the state commissions assessing the merger's impact on generation and distribution market power. The proposal contains five steps: (1) the applicants file their applications simultaneously at both the federal and state levels; 2 each state commission determines whether the merging utility operating in the state has pre-merger market power with the several states sharing their data resources methodologies and modeling capabilities, and possibly undertaking a joint review) (3) the Commission analyzes the transmission systems affected by the merger relying on a Guideline type analysis to assure that transmission constraints do not create barriers to entry by competing generators; (4) all regulators then collaborate to determine if the merging entities will likely possess any regional post merger market power and (5) the merger is either approved outright approved with conditions, or set for hearing by the various regulators. Whether it is set for hearing would depend on whether there is agreement among the state regulators that the applicants will possess no local or regional generation market power and whether the Commission determines that no transmission barriers to market entry can be identified.

151/ E.g., Southwestern.

152/ Southern, NY Com, and OH Com.

DOJ urges the Commission to adopt the Guidelines so that there will be consistency between DOJ and the Commission. As discussed above many others echo this view. PP&L urges the Commission routinely to obtain the views of DOJ and the FTC about each merger application. Further, PP&L suggests that the Commission could require an evidentiary hearing if DOJ or the FTC suggests that a hearing is necessary or opposes the merger. PP&L also proposes that the Commission require the filing of the Premerger Notification forms that merging parties must file with the DOJ and the FTC under the Hart-Scott-Rodino Antitrust Improvements Act 153/ PP&L claims that the information in these forms would be useful to the Commission in evaluating mergers.

Several commenters argue that we should limit the scope of merger proceedings to issues that are directly related to the merger and not allow intervenors to raise extraneous issues or extract concessions 154/ Moreover, we should not use merger proceedings as an alternative means of promoting or requiring the generic restructuring of the electric industry. 155/

D. Remedies

No commenter says that a merger must be rejected if it fails initially to satisfy the public interest test. Commenters recommend certain courses of action to remedy the initial failure. These include items such as: settlement; a merger condition closely related to the difficulty (i.e., divestiture, releasing wholesale customers); and voluntary mitigation measures.

Several commenters ask the Commission to monitor the effects of a merger after it is approved either to verify claimed benefits or to detect anticompetitive effects that escaped the analysis. 156/ We could grant relief from negative effects or impose new conditions. 157/ APPA recommends that approval of a merger be conditioned on a post hoc review of market performance, including consideration of the effect on rates. EGA suggests that the Commission should impose "provisional" or "contingent" conditions on a merger; that is, conditions that the merged companies must comply with if certain future circumstances occur.

153/ 15 U.S.C. 18a (Supp. 1996).

154/ E.g., Southwestern, Com Ed.

155/ E.g., Southwestern, Southern.

156/ E.g., APPA, Joint Consumers Advoc., NRECA.

157/ E.g., APPA, EGA, NRECA.

CINergy suggests post-merger analysis as an alternative to extensive pre-merger analysis. It urges the Commission not to burden merger applicants with a requirement to forecast potential merger effects under various industry and state restructuring scenarios. Such a requirement would paralyze the merger application process and yield only speculative results. CINergy suggests that, if the Commission does ask for such an extensive analysis, we should offer merger applicants the alternative of filing a new market analysis every three years for ten years after merger approval; as a condition of merger approval the applicants would agree that if the Commission finds too much market power in a new market analysis they will implement any necessary mitigation measures, including generation divestiture.

On the other hand some commenters advise against post merger reviews and conditions.^{158/} They argue that ongoing Commission review or a suggestion that approval may be reversed would introduce uncertainty in the market and prevent the proper pricing of a merger.

Most commenters do not deny that the Commission has authority under section 203 to impose conditions on its approval of a merger. Rather some commenters debate the scope of such conditions.^{159/} Several say that the Commission has the authority to impose conditions only if there is a detriment to the public interest, and then only in ways related to the specific detrimental effects. Florida and Montaup asserts that there is no authority to order divestiture as a condition.

Project recognizes that NEPA does not expand our powers under the FPA. However, it says that the Commission has ample authority under the FPA, given its NEPA obligations, to condition its approval of mergers to promote NEPA goals and policies.

Several commenters urge the Commission to impose a particular condition on its approval of all or most mergers. Their principal argument is that mergers generally have a negative effect on competition. Recently the Commission counterbalanced this effect by requiring open transmission access, which enhanced competition. The Commission should replace the open access condition with a new condition that enhances competition to ensure that the merger is procompetitive. TAPS, for example, supports this view.

Other commenters would impose a condition only to remedy a specific problem. For example, EGA and DOJ argue that the Commission should impose a procompetitive condition only to prevent harm to competition. TDU Systems suggests that the

158/ Among others, PaineWebber.

159/ For example, FTC, PS Colorado, Southwestern, and Southern.

Commission consider mitigation of harm to competition only after it has assessed the likely competitive consequences of an unconditioned merger on the market structure. TDU Systems also believes that we should remedy each likely anticompetitive effect of a merger even in cases in which the merger overall seems likely to have public benefits. Environmental Action et al. would approve mergers with anticompetitive effects only if the Commission can impose conditions that will mitigate the anticompetitive effects of the merger.

Some commenters distinguish imposing a condition on a merger (for example, an open access tariff that must be filed for the merger to be approved) from conditional approval of a merger (the merger is approved for now but if it has a negative effect, the approval can be revoked or made subject to a new condition). Several commenters (e.g., NRECA, PP&L and RUS) caution the Commission to use only sparingly its authority to approve mergers on a conditional basis. While this "reach-back" authority may be appropriately used in "fast-track" merger approvals it should not be routinely relied upon as a substitute for either the rejection or mitigation of mergers that are likely to have significant anticompetitive effects.

Centerior argues that conditioning authority should be used sparingly and only in those situations where the Commission finds that there is a high possibility of specific harm to competition. Commenters offer several arguments against imposing a generic merger condition or having a low threshold for imposing a condition.

Not all mergers are alike, so it is not appropriate to impose the same condition on all merger approvals, according to others. 160/ A condition should be related to the effects of a specific merger.

Southern argues that any generic merger conditions would go far beyond the approach of the Guidelines which are aimed merely at preventing mergers that would "create or enhance market power or facilitate its exercise." Generic merger conditions are typically designed to require merger applicants to establish positive merger benefits, contrary to FPA and antitrust precedent. Some argue that we should not use merger approval as a tool for achieving an unrelated policy goal. They say that this would discourage procompetitive mergers. 161/

160/ For example, Southern, DOJ, FTC, and Wisconsin PS.

161/ For example, Com Ed, Southwestern, DOJ, FTC, Paine Webber, EEI, Wisconsin PS, and Florida and Montaup.

Commenters proposed over a dozen specific conditions for merger approval. Some conditions are proposed for all mergers and others to remedy a problem with a specific merger. Most of the suggested conditions are designed to mitigate market power or to ensure that rates do not increase as a result of the merger. The proposals are to require the merged company to:

(a) Form an ISO

Some urge the Commission to require merging parties to form an ISO or to participate in a regional ISO, resulting in single-system, regionwide nonpancaked transmission rates. 162/ For instance the WI Com would require an ISO or transmission divestiture where the merging companies own a major transmission bottleneck. Otter Tail and Industrial Consumers view the ISO as one possible way to mitigate market power.

(b) Divest generation or transmission assets

Some commenters support generation divestiture as a remedy for an anticompetitive merger 163/ The FTC believes that this remedy would remove the anticompetitive effect of the merger without hampering its procompetitive or efficiency-enhancing aspects. Wisconsin PS would impose divestiture only if it would prevent the exercise of market power. Project would require all merging companies to separate their distribution assets and functions from the generation business within a reasonable time, creating legally and functionally separate entities to provide the different services.

Wisconsin Customers appears to advocate divestiture of transmission from generation and distribution as a condition of all merger approvals. It sees divestiture as preferable to an ISO because the Commission would not have to perpetually construct rules to avoid unfair use of the transmission system and then monitor compliance.

Both Southern and Centerior oppose divestiture as a drastic action that would probably kill efficient mergers or limit the ability of the merged company to compete.

(c) Reform transmission pricing

Several commenters argue that elimination of rate pancaking

162/ TAPS, Wisconsin Customers, WI Com, and APPA.

163/ For example, FTC, PP&L, Wisconsin Customers, and Lubbock.

should be a condition for all mergers. 164/

APPA and TDU Systems urge the Commission to codify or apply as a general condition its current requirement of single system transmission pricing for all merged systems, unless the applicants show a public interest basis for different treatment. TDU Systems also suggests that all merging parties be prevented from reducing the transmission capacity presently available for use by transmission customers. Environmental Action et al. would prohibit market pricing for power transactions among affiliates of merged companies in regions lacking regional transmission pricing.

(d) Eliminate transmission constraints

Some commenters state that transmission constraints should be addressed by conditioning the approval of the merger on the applicants' building facilities to alleviate the constraints or taking other measures to eliminate local market power. 165/

Competitive Coalition and TDU Systems suggest that where two constrained systems are merging, divestiture of transmission assets should always be considered.

Southern Company cautions against becoming overly concerned with remedying transmission constraints by imposing conditions or by market definition, since other potential remedies or alternatives exist.

(e) Have retail access

Competitive Coalition realizes that the Commission's authority does not extend to ordering direct access at the retail level, but suggests that the concerns over monopsony would be eliminated if merging parties offered open-access distribution. Industrial Consumers, supported by Otter Tail, recommend that where necessary to avoid anticompetitive effects, we condition approval of mergers by adjacent suppliers on their agreement to provide nondiscriminatory direct access or a finding that a state's adoption of a direct access initiative avoids anticompetitive concerns.

(f) Forego stranded cost recovery

Several commenters see a need to require all merging parties to forego stranded cost recovery in order to mitigate market

164/ For example, OK Com, NV Com, CCEM, and TDU Systems.

165/ For example, Florida and Montaup and Wisconsin PS.

power. 166/

(g) Reform contracts

Commenters argue that all merging utilities should be required to offer an open season for all of their wholesale requirements contracts and transmission contracts. UtiliCorp argues that many utilities and wholesale customers remain bound to requirements contracts that impede their ability to take advantage of the benefits of the recent competitive influences in the market. 167/

To achieve unrestricted wholesale competition, Competitive Coalition calls for the complete unbundling of transmission services to be required of all merger applicants, including the transmission services contained in existing requirements contracts. It would also extend the unbundling requirement to the transmission services embodied in pooling or bilateral coordination and joint transmission agreements to which merger applicants are parties.

(h) Eliminate affiliate advantage

APPA urges the Commission to adopt standard conditions for utility mergers to govern affiliate transactions.

(i) Monitor achievement of claimed benefits

Joint Consumer Advoc. argues that there should be a mechanism to monitor whether claimed benefits are actually achieved, but does not offer any specific proposals.

166/ Industrial Consumers, Otter Tail, TAPS, and Wisconsin Customers.

167/ For example, UtiliCorp, CCEM, Wisconsin Customers, and Southwestern Electric.

(j) Freeze or reduce rates

Several commenters advocate guaranteed cost reductions to be passed on to consumers or rate freezes by the merger applicants. 168/ This would be a condition to overcome the potentially anticompetitive effects of the merger and to ensure that claimed benefits of the merger are received.

Environmental Action et al. believes that a better approach than rate freezes is to simply set rates appropriately.

Florida and Montaup argues that the Commission should not require rate freezes as a condition of approving a merger or a condition to avoiding a hearing on a rate freeze. WI Com discounts the value of a four-year rate freeze if a utility will no longer have restrictions on its pricing other than the market by the year 2000. It prefers a market structure that ensures that customers have access to many suppliers, none of which will be able to exercise significant market power over the long term.

CINergy, with support from OK Com, argues that rather than debating claims of net benefits, the Commission should protect customers by requiring all merging companies to commit not to recover merger-related costs from ratepayers. Low-Income Representatives would condition all mergers to: (1) continue existing rates, payment programs protections regarding customer service, and shut-offs for low-income consumers; and (2) assure no impact on attaining or maintaining universal service.

(k) Retain generation reserve sharing and other coordination arrangements

TAPS and TDU Systems believe that the Commission should consider imposing a requirement that all merged utilities engage in joint planning and joint ownership of future facilities, continue to offer basic reserve sharing and coordination services, and continue to offer cost-based firm full requirements and partial requirements service.

(l) Maintain reliability and the quality of service

International Brotherhood would require every merger application to contain a plan to maintain or improve reliability and the quality of service.

168/ Joint Consumer Advoc., Industrial Consumers, Otter Tail, CINergy, Illinois Industrials, and Texas Industrials.

(m) Eliminate economic impacts

International Brotherhood would require every merger application to demonstrate a lack of adverse economic impact on the economy of the communities served.

(n) Eliminate environmental impacts

Project would condition mergers to mitigate significant adverse environmental impacts identified in an environmental assessment. It would require applicants to bring existing generation units up to standards comparable to the environmental restrictions on their competitors, in effect, to hold the environment harmless from merger-related impacts.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO
FROM ROBERT W. GEE**

Q.1.a. What authority to approve acquisitions, mergers, and diversifications by utility holding companies do State commissions have?

A.1.a. Attached are pages taken from the NARUC's most-recently published report on State regulatory policies describing State commission jurisdiction over such activities when conducted by a utility company regulated by the regulatory commissions of the respective States.¹ As the charts indicate, the majority of State commissions have authority under State law to address transactions in which the regulated utility is involved, and some also report that they have authority to regulate entry of a utility affiliate into diversified lines of business.

Problems may arise, however, when the merger, acquisition, or diversification activities occur at a level within the holding company system in which the utility subsidiary is not directly involved. As a general matter, holding companies strongly resist any and all efforts by State regulators to extend their reach to matters not directly involving a utility. For example, if a parent holding company decides to diversify into a new, and potentially risky, line of business through a nonregulated subsidiary, that holding company will assert that the State commissions regulating the operating company have no authority to regulate this transaction directly or indirectly, even if it places utility shareholder interests at risk. Rather, the holding companies assert that the State commission's rate-making authority with respect to the utility subsidiary is sufficient regulatory protection.

Q.1.b. Do State public service commissions have the authority to require prior approval of affiliate transactions or of diversification for the holding companies which operate within their States?

A.1.b. As was stated in the previous answer, the extent of State commission authority is dependent upon how the holding company structures its transactions; if an operating utility is not directly involved in the affiliate or diversification transaction in question, holding companies will vehemently resist any suggestion that a State commission can or should have the authority to approve such transactions in advance, regardless of the geographic location of the activity or the impact on consumers of the utility subsidiary. A State commission that is seeking to exercise its authority to require prior approval for actions taken at the holding company level will face the substantial likelihood of prolonged and expensive litigation under State law, pre-emption, and Commerce Clause grounds.

Q.1.c. What additional authority, if any, is needed in order to protect consumers from market power abuses considering Department of Justice antitrust investigations and FERC authority to approve mergers and acquisitions?

A.1.c. Just last year, Congress determined that neither antitrust investigations nor FERC regulation under the Federal Power Act were adequate remedies in cases in which utility holding companies diversified into telecommunications. Concerned that registered

¹"Compilation of Utility Regulatory Policy in the United States and Canada, 1995-1996" at 91-96 (1996).

holding companies would be able to leverage the market power in their core utility markets to cross-subsidize their entry into telecommunications, Congress amended PUHCA to permit registered holding companies to acquire interests in communications subsidiaries, but only on the following conditions: that all State commissions regulating the holding company give prior consent to transfer of assets from a utility to its telecommunications company (ETC), that the SEC retain jurisdiction over the "relationship" between an ETC and its parent holding company, that holding companies be subject to a continuing obligation to report their "investments and activities" involving ETC's, that holding companies be barred from pledging utility assets to support ETC activities, that holding companies obtain prior State commission approval of any contracts between its utility and ETC subsidiaries, and that State commissions be provided with a Federal right of access to holding company books and records concerning ETC activities and independent audit authority.

During last year's debate, the NARUC advocated the inclusion of these provisions in the Telecommunications Act. We continue to believe that these types of conditions on holding company diversification should be codified in Federal law on a generic basis for as long as utility holding companies retain market power in their core gas and electric markets.

Q.1.d. Will S. 621 hinder the State public service commissions' ability to exercise their rate-making authority?

A.1.d. As a legal matter, S. 621 will not hinder State commission ability to exercise rate-making authority because it does not appear to restrict, prescribe, or otherwise pre-empt State authority. However, as a practical matter, the passage of S. 621 will make State commission rate-making decisions more complex by increasing the opportunity for holding companies to diversify into new lines of business and enter into new types of affiliate relationships with utility subsidiaries, and by changing the overall risk profile of the holding company system. Each of these factors—which PUHCA now eliminates—will need to be considered by State regulators exercising authority over utility subsidiaries.

Q.2. In your opinion, how would this legislation affect the ability of companies, States, and Federal regulators to restructure as the energy industry moves toward competition and deregulation?

A.2. There can be very little doubt that PUHCA affects competition. Congress has recognized as much when in the Public Utility Regulatory Policies Act (PURPA) and also the Energy Policy Act (EPA), it exempted QF's (in § 210(e) of PURPA) and EWG's (codified in § 32(a)(1) of PUHCA) from the Holding Company Act in order to allow greater competition in bulk power markets by increasing the universe of potential entrants and by removing regulatory impediments to market entry. Because the EPA's PUHCA exemption only applies to wholesale generators, PUHCA remains an impediment to generators that seek to enter retail markets.

Moreover, PUHCA is structured in order to address a vertically-integrated, monopoly-service-territory model of the industry organization. Indeed, section 11(a) of PUHCA imposes on the SEC the obligation to regulate utility holding companies in a manner "ap-

propriate to the operations of an integrated public utility system." By contrast, as now understood, "industry restructuring" means the unbundling of utility services into discrete parts, through cost allocation procedures, structural separation, or divestiture of lines of business, i.e. to allow customers to choose to purchase services in a distinctly non-integrated manner, at least with respect to the services they purchase from their formerly vertically-integrated utility provider. Accordingly, to the extent that unbundling is both necessary to greater competition and inconsistent with the integration requirements of section 11, PUHCA's continued existence will affect, and perhaps retard, implementation of competitive markets.

However, to the extent that the repeal or substantial modification of PUHCA through the enactment of S. 621 allows for incumbent holding companies to exploit the market power they retain as a result of holding substantial generation, transmission, and distribution assets and systems, amendments to PUHCA could harm the development of competitive markets. Of particular concern is the possibility that such amendments could allow utility holding companies to diversify into new markets through reliance on the advantages provided by having a captive customer base in a protected home market. Further, repeal or modification of PUHCA could accelerate the current merger trend leading to greater industry consolidation. Utility mergers could recreate the market power problems that unbundling of generation assets was intended to mitigate.

Q.3. In your testimony you state that PUHCA reform should wait for full energy deregulation to "ensure that the authority of the States to regulate utility holding companies is not pre-empted or restricted." In the *Ohio Power* case, the Supreme Court held that rate regulators could not rule on utility costs, as they relate to consumer energy rates, if the costs had been previously approved by the SEC. What affects do PUHCA and S. 621 have on the ability of the State commissions to determine fair costs and utility rates as it relates to the *Ohio Power* decision?

A.3. In *Ohio Power Co. v. FERC*, 954 F.2d 779 (D.C. Cir. 1992), the U.S. Court of Appeals for the District of Columbia Circuit held that the FERC must allow a utility to include the costs of coal purchased from an affiliated supplier in the utility's *wholesale rates* where the contract between the utility and the coal company had been approved by the SEC under section 13 of PUHCA. To our knowledge, this holding has not been extended by any court to require State commissions to include the costs of goods and services purchased from affiliates in *retail rates*. However, in our view, the *Ohio Power* decision places State commissions at risk of the same type of pre-emption to which the FERC is now subject. Accordingly, it has been the NARUC's position since the D.C. Circuit's decision was issued that Congress should amend PUHCA to ensure that neither the FERC nor State commissions are required to automatically pass through the costs of affiliate contracts in wholesale and retail rates respectively.

By repealing section 13 of PUHCA, S. 621 would then remove the statutory basis for the D.C. Circuit's decision. Moreover, S. 621 eliminates the role of the SEC in the regulation of utility holding

companies, so there would no longer be two Federal agencies with potentially incompatible regulatory policies. As a result, S. 621 would effectively reverse the holding of *Ohio Power*—the FERC would no longer have to allow utilities to pass through in wholesale rates the costs of affiliate contracts approved by the SEC under section 13 of PUHCA. By repealing section 13, S. 621 would also eliminate the risk that a State commission's retail rate orders would be pre-empted by the SEC.

Moreover, section 8 of S. 621 states that the Act shall not be construed to pre-empt FERC or State regulation of the costs of affiliate transactions involving a regulated utility subsidiary. While being beneficial to State jurisdiction, this section does not restore to the States the authority taken from them by the Supreme Court's construction of the Federal Power Act in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). In that case, the Court held that a decision of the FERC approving the sale of wholesale power from an affiliated supplier to a retail utility served to pre-empt the State authority to determine whether the costs of the power were prudent and recoverable from retail customers. It is the NARUC's longstanding position that Congress should take action to reverse this decision and thereby restore the authority of the States to (1) review the costs of power purchased by a utility from an affiliate in all cases, and (2) where appropriate, refuse to allow the utility to pass through such costs to retail customers when better supply alternatives are available in the market. We again urge that Congress ensure that State commissions have the unquestioned authority to require that utilities serving retail customers take full advantage of increasingly competitive wholesale power markets rather than continue to rely on above-market power purchases from affiliates.

Q.4. In your testimony you state that the legislation should be clarified to ensure that States are not pre-empted by FERC decisions. How would you suggest the language be clarified?

A.4. As noted in the previous answer, S. 621 does not protect State commissions from FERC pre-emption of their authority to review the costs of power purchased at wholesale from affiliated suppliers. Section 8 of S. 621 can be easily amended to restore this critical State authority. Specifically, section 8 should be amended to read as follows:

Nothing in Federal law shall preclude the Commission or a State commission from exercising its jurisdiction under otherwise applicable law to determine whether a public utility company may recover in rates any costs of an activity performed by an associate company, or any costs of goods or service acquired by such public utility company from an associate company.

Substituting the words "in Federal law" for the words "in this Act" should be sufficient to insulate State authority over affiliate relationships from pre-emption by the FERC under the FPA.

The legislation also should make clear that the exemption authority provided to the FERC under section 7 only applies to the Commission's regulatory powers. Unlike legislation in the last Congress, this bill limits the FERC's authority to issue exemptions to its ability to obtain access to books and records under section 5.

However, we would recommend that provisions be included in report language affirming that section 7 may not be used to displace any authority conferred on State commissions by this bill or under other applicable law.

Q.5. Under S. 621 would the State public service commissions have authority to look at the books and records of companies that don't conduct business with a public utility company? Under what circumstances would public service commissions need access to the books and records of such affiliates or subsidiaries of the holding company?

A.5. Section 6(a) of S. 621 provides State commissions access to the books and records of "a holding company or its associate company or affiliate thereof, wherever located." There is no requirement that such companies directly transact business with a public utility affiliate. Rather, books and records must be made available if they have been identified in reasonable detail by a State commission, are deemed relevant by the State commission, and are necessary for the State commission to discharge its responsibilities. Books and records of an affiliate that meet this test are available to the State commissions whether or not the affiliate company conducts business with the utility.

The circumstances for which access is needed are described in this test: relevance to utility costs and rates, and necessary for the State commission to protect the public interest. For example, a multi-state utility holding company may allocate joint and common costs among numerous non-utility affiliates that may not transact business directly with the public utility affiliate regulated by the State commission. Nonetheless, access to the books and records of these affiliates may be essential for the commission to determine whether the utility company is allocated only its reasonable share of the costs.

Q.6. S. 621 exempts from the Federal books and records provisions companies which are holding companies only because they own Qualifying Facilities, EWG's, and Foreign Utility Companies. What authority do States have to regulate these entities currently? How will S. 621 change State regulation of these companies?

A.6. The authority of the State to regulate these three entities varies due to the application of different provisions of Federal law. Because of these differences, each would be affected differently under S. 621.

Qualifying Facilities (QF's): QF's are creatures of Title II of the Public Utility Regulatory Policies Act of 1978 (PURPA). Under section 210, QF's are provided the right to sell power at wholesale to regulated utilities and to receive prices for their sales based on the costs the purchasing utility would otherwise pay to generate or purchase the power from another source. This pricing standard—called the avoided cost standard—is implemented by the State regulatory commission with jurisdiction over the purchasing utility. As a practical matter, State commissions also play a role in approving the power supply contracts between utilities and QF's that embody these prices, as well as other terms and conditions. S. 621 does not affect PURPA, thereby leaving State regulation of QF sales intact.

Exempt Wholesale Generators (EWG's): EWG's were created by the Energy Policy Act through the addition of section 32 of PUHCA. Under this section, an interest that a holding company acquires in an affiliate which is exclusively engaged in generating electric energy to be sold at wholesale is exempt from PUHCA's otherwise applicable restrictions, provided that certain conditions are met. Some of these conditions involve State regulation. For example, under section 32(c), a holding company may not transfer facilities from a utility subsidiary to an EWG subsidiary without specific authorization by each State exercising jurisdiction over the utility. Further, under section 32(k), an EWG may not enter into a contract to sell power to a utility affiliate without the prior approval of each State commission regulating the utility. S. 621 would repeal section 32 of PUHCA, thereby abolishing EWG's as a separate category of generators, along with this State commission role.

However, unlike PURPA with respect to the QF's, section 32 of PUHCA does not exempt EWG's from either the Federal Power Act (FPA) or State utility regulation. As a result, the rates for wholesale sales by an EWG are subject to regulation by the Federal Energy Regulatory Commission under the FPA. Further, a utility's purchase of power from an EWG for resale to retail consumers is subject to State commission review as to whether the purchase is prudent, reasonable, or necessary. Because S. 621 does not affect the FPA and expressly preserves State utility law from pre-emption (sections 8 and 10), wholesale sales from entities that were EWG's under section 32 of PUHCA would continue.

Foreign Utility Companies (FUCO's): FUCO's were also created by the Energy Policy Act through the addition of section 33 of PUHCA. This section exempts from PUHCA's restrictions any interest a holding company may acquire in an affiliate which owns or operates foreign utility companies, i.e. utility companies located outside the United States and earning no income from electric or natural gas transactions within the United States. Section 33 provides different roles for State commissions depending on whether the holding company owning the FUCO affiliate was a registered or an exempt system. For example, under section 33(a)(2), exempt holding company systems may not acquire an interest in a FUCO until they obtain a certification from each State commission exercising jurisdiction over a utility subsidiary that the individual State commissions have the statutory authority and resources to protect consumers from any direct or indirect effects FUCO ownership may create. By contrast, under section 33(c), a registered holding company may acquire an interest in a FUCO without prior approval by either the SEC or State commission. The only role for State commissions regulating a utility subsidiary of a registered system is to make recommendations to the SEC that concern the issuance of securities by the holding company necessary to finance the acquisition of the FUCO. Because S. 621 would repeal section 33 of PUHCA, the ability of the States to grant or deny certification in the case of exempt holding companies or make recommendations in the case of registered holding companies would be abolished.

TABLE 32 - AGENCY AUTHORITY OVER UTILITY COMPANY RESTRUCTURING

AGENCY	Agency Approval is Required Prior to:		The Agency -		Participates as a Party in Reorganization Proceedings	Agency Has Authority to:			Approved Diversifications
			Requires Submission of Proposed Accounting for:			Disqualify Directors/Officers When Interlocking Directorates or Conflicts of Interest are Involved	Regulate: Entry of Utility Into Non-Utility Activity, Either Directly or via Affiliate		
	Mergers	Consolidations	Mergers	Consolidations					
FCC	X	X	X	X		X	X	10/	X
FERC	X 1/	X 1/	X	X	32/	X			
ALABAMA PSC 31/	X	X	X	X			X		
ALASKA PUC 31/	X	X	X	X			X 22/	X	
ARIZONA CC	X	X	X	X	X				
ARKANSAS PSC	X	X	X	X	X		X 10/		
CALIFORNIA PUC	X	X	X	X	X				
COLORADO PUC	X	X	X	X	7/		X		
CONNECTICUT DPUC	X	X	X	X					
DELAWARE PSC 31/	X	X	X	X	X			23/	
DC PSC	X	X	X 6/	X 6/					
FLORIDA PSC	X	X	X	X			X 10/		
GEORGIA PSC	X	X	X	X			X 10/	X	
HAWAII PUC	X 2/	X 2/	X 2/	X 2/					
IDaho PUC	X	X	X	X	7/	X	24/	X 10/	
ILLINOIS CC	X	X	X	X					
INDIANA URC 20/	X	X	X	X					
IOWA UB 31/	X 3/	X 3/	X	X					12/
KANSAS SCC 31/	X	X	X	X	X	8/	X 12/	X	
KENTUCKY PSC	X	X	X	X	X		X		
LOUISIANA PSC 31/	X	X	X	X	X		X	X	
MAINE PUC	X	X	X	X					
MARYLAND PSC	X	X	X	X			X		
MASSACHUSETTS DPU 31/	X	X	X	X			X 10/	X 15/	
MICHIGAN PSC	X	X	X	X			X 25/		
MINNESOTA PUC 31/	X	X	X	X					
MISSISSIPPI PSC	X	X	X	X					
MISSOURI PSC	X	X	X	X					
MONTANA PSC	X	X	X	X					
NEBRASKA PSC	X	X	X	X					
NEVADA PSC	X	X	X 6/	X 6/			26/		
NEW HAMPSHIRE PUC	X	X	X	X	X	X	X	X	
NEW JERSEY BPU 31/	X	X	X	X	X	27/	X 13/	X 16/	
NEW MEXICO PUC	X	X	X	X		28/	X 11/	X 11/	
NEW MEXICO SCC 31/18/	X	X	X	X			X 29/	X	
NEW YORK PSC 31/	X	X	X	X	X		X 11/	X 17/	
NORTH CAROLINA UC	X	X	X	X		X			
NORTH DAKOTA PSC	X	X	X	X	X				
OHIO PUC	X	X	X	X	X		15/	15/	
OKLAHOMA CC	X	X	X	X		X			
OREGON PUC	X	X	X	X	X		X 11/	X 11/	
PENNSYLVANIA PUC	X	X	X	X	X				
RHODE ISLAND PUC	X	X	X	X	X		8/	X 11/	
SOUTH CAROLINA PSC	X	X	X	X					
SOUTH DAKOTA PUC 31/	X	X	X	X					
TEXAS PUC 31/	X	X	X	X	X				
TEXAS RC	X	X	X	X					
TEXAS NRCC	X	X	X	X					
UTAH PSC	X	X	X	X	X		X		
VERMONT PSB	X	X	X	X	X				
VIRGINIA SCC	X 5/	X 5/	X	X			X		X
WASHINGTON UTC	X	X	X	X	X 4/		X 10/		
WEST VIRGINIA PSC	X	X	X	X	X	X	X 30/	X	
WISCONSIN PSC	X	X	X	X		9/	X		
WYOMING PSC	X	X	X	X					
PUERTO RICO PSC 31/	X	X							
VIRGIN ISLANDS PSC31/	X	X	X	X					
CANADIAN RTC	X	X	X	X				14/	
NATL ENERGY BOARD	X	X	X	X			X 10/		
ALBERTA EUB	X	X	X	X			X		
NOVA SCOTIA UARB	X	X	X	X					
ONTARIO EB	X	X	X	X					
QUEBEC MGB 31/	X	X	X	X					

FOOTNOTES - TABLE 32 - AGENCY AUTHORITY OVER UTILITY COMPANY RESTRUCTURING

- 1/ Yes for gas facilities. Yes for electric facilities (public utility facilities) valued at \$50,000 or more. Qualifying Facilities are automatically exempt from FERC accounting requirements. Accounting requirements have been waived on a case-by-case basis for Independent Power Producers, Affiliated Power Producers, Exempt Wholesale Generators and others.
- 2/ But only if it is at the operating company level.
- 3/ Board may disapprove transactions involving the whole or substantial part of utilities' assets or controlling interest of capital stock.
- 4/ If securities are to be issued.
- 5/ Gas, electric, water and sewerage. New law, effective July 1992, requires SCC approval before acquisition or disposition of facilities in place of any public utility or municipality for the production, transmission or distribution of electric energy, gas, or the furnishing of sewerage facilities or water.
- 6/ Accounting subject to review in compliance audits.
- 7/ Commission has broad powers to regulate utilities under general statutes.
- 8/ Determination never made.
- 9/ Probability of some authority in these areas under Commission's general authority, but never exercised.
- 10/ Such activity must not adversely affect utility.
- 11/ Utility ratepayers do not absorb any risks or costs of such activities.
- 12/ Limited control where mergers are proposed and when stock and other securities are to be issued.
- 13/ Purpose must be lawful and provide some advantage to utility and its customers. No recent cases.
- 14/ Not over entry, but regulations to insure against cross-subsidization.
- 15/ As a condition of permission to lend money, an effort is made to restrict activities of non-regulated companies.
- 16/ Subsidiaries for acquiring land for utility purposes or disposition of property no longer used or useful.
- 17/ Coal mining operations directly related to utility activities and method of pricing the coal have been under Commission surveillance.
- 18/ Agency does not regulate electric or gas utilities.
- 19/ Agency does not regulate electric or telephone utilities.
- 20/ Section 83(a) of the Indiana Utility Regulatory Commission Act states in part "No public utility...shall sell, assign, transfer, lease, or encumber its franchise, works, or system...without approval of the commission after hearing."
- 21/ Sale, transfer of assets, or merger must be reported within a reasonable time. If in the next rate case the transaction is found not in the public interest, its effect is disallowed in rates.
- 22/ For jurisdiction over holding company, see Allocation of Administrative and General Costs *Re Tucson Electric Power Co.*, 149 PUR4th 251 (1994).
- 23/ For jurisdiction over holding company, see Telephone Holding Companies-Audits-Access to Records *Re C&P Telephone Co.*, 148 PUR4th 113 (1993), *C&P Telephone Co.*, 130 PUR4th 310 (1992), *C&P Telephone Co.*, 12 DCPSC 407 (1991).
- 24/ For jurisdiction over holding company, see Independent Power Activities *Re Illinois Power Co.*, 152 PUR4th 98 (1994), *Illinois Power Co.*, 147 PUR4th 225 (1993).
- 25/ For jurisdiction over holding company, see Affiliate Transactions-Transfer of Assets-Corporate Records *Re Michigan Consolidated Gas Co.*, 147 PUR4th 1 (1993), *Consumers Power Co.*, 127 PUR4th 285 (1991), *Consumers Power Co.*, 112 PUR4th 241 (1990).
- 26/ For jurisdiction over holding company, see Corporate Relationship-Access to Records *Re Sierra Pacific Power Co.*, 129 PUR4th 470 (1992).
- 27/ For jurisdiction over holding company, see Interlocking Directorates-Diversification *Re Public Service Enterprise Group*, 144 PUR4th 351 (1993), *Public Service Enterprise Group*, 139 PUR4th 153 (1993).
- 28/ For jurisdiction over holding company, see Diversification-Rate Penalties *Re Public Service Company of New Mexico*, 139 PUR4th 245 (1992).
- 29/ For jurisdiction over holding company, see Cross-subsidies-Royalty Payments *Re Rochester Telephone Corp.*, 147 PUR4th 289 (1993).
- 30/ For jurisdiction over holding company, see Energy Services Activities-Business Practices *Re Wisconsin Power & Light Co.*, 151 PUR4th 165 (1994).
- 31/ Agency did not respond to request for update information; this data may not be current.
- 32/ Commission staff will participate as a "party" if the proceedings are set for formal hearing.

TABLE 33 - AGENCY AUTHORITY OVER UTILITY SALE OF FACILITIES AND PROCUREMENT

AGENCY	Agency Approval is Required Prior to Purchase or Sale of Facilities (Entire Operating Units)		Agency Requires Submission of Proposed Accounting For:		The Agency Requires -				Agency Audits Equipment Procurements to Insure Costs are Reasonable
	Purchase	Sale	Purchases	Sales	Procurement Policy to be Established	Approval of any Procurement Contracts	Advance Submission of Budgets on Capital Expenditures	Approval Prior to Entrance into Major Lease Transactions	
FCC	x	x	x	x				x 12/	x
FERC	x 1/	x 1/	x 20/	x 20/	19/				x
ALABAMA PSC	23/	x	x	x				x	x
ALASKA PUC	23/	x	x	x			x		x 15/
ARIZONA CC		x	x	x					
ARKANSAS PSC		x	x	x	x			x	x 15/
CALIFORNIA PUC		x	x	x	x			x 13/	
COLORADO PUC		x	x	x	x	x		x	
CONNECTICUT DPUC		x	x	x	x			x	
DELAWARE PSC	23/	x	x	x				x	
DC PSC			x	x				x	x
FLORIDA PSC		x 2/	x 2/	x 7/	x 7/			x	x
GEORGIA PSC		x	x	x	x			x	
HAWAII PUC		x	x	x	x			x	x 3/
IDAHO PUC		x	x	x	x			x	x
ILLINOIS CC		x	x	x	x	x 9/		x	x
INDIANA URC		x 3/	x	x	x			x 11/	x
IOWA UB	23/	x 4/	x 4/	x	x				x 9/
KANSAS SCC	23/	x	x	x	x				x 16/
KENTUCKY PSC		x	x	x	x			x	
LOUISIANA PSC	23/	x	x	x	x				
MAINE PUC		x	x	x	x			x 22/	x 15/
MARYLAND PSC		x	x	x	x			x	
MASSACHUSETTS DPUC	23/	x	x	x	x				
MICHIGAN PSC			x	x	x				
MINNESOTA PUC	23/	x	x	x	x				
MISSISSIPPI PSC		x	x	x	x				x
MISSOURI PSC		x	x	x	x			x	x
MONTANA PSC		x	x	x	x				x
NEBRASKA PSC	17/	x	x	x	x				
NEVADA PSC		x	x	x 7/	x 7/			x	x
NEW HAMPSHIRE PUC		x	x	x	x	x		x	x
NEW JERSEY BPU	23/	x	x	x	x			x	x 16/
NEW MEXICO PUC		x	x	x	x			x	
NEW MEXICO SCC	23/17/	x	x	x	x				
NEW YORK PSC	23/	x	x	x	x	x 10/	x	x	x
NORTH CAROLINA UC		x	x	x	x	x 9/	x	x	
NORTH DAKOTA PSC		x	x	x	x				
OHIO PUC		x	x	x	x				x -
OKLAHOMA CC		x	x	x	x				
OREGON PUC		x	x	x	x			x	x
PENNSYLVANIA PUC		x	x	x	x	for fuel	x	x	
RHODE ISLAND PUC		x	x	x	x			x 3/	
SOUTH CAROLINA PSC		x	x	x	x			x	
SOUTH DAKOTA PUC	23/	x	x	x	x			x 14/	
TEXAS PUC	23/	x	x	x	x			x	
TEXAS RC	18/	21/	21/	x	x				
TEXAS WRCC	N/A								
UTAH PSC		x	x	x	x			x	
VERMONT PSB		x	x	x	x			x	
VIRGINIA SCC		x 3/	x 3/	x	x	x		x	
WASHINGTON UTC		x 6/	x 3/	x 6/	x 3/			x 9/	
WEST VIRGINIA PSC		x	x	x	x			x	
WISCONSIN PSC		x	x	x	x			x	x
WYOMING PSC		x	x	x	x				x 16/
PUERTO RICO PSC	23/	x	x	x	x			x	
VIRGIN ISLANDS PSC	23/	x	x	x	x			x	
CANADIAN RTC		x	x	x	x			x	x
NATL ENERGY BOARD		x	x	x	x	x 8/	x 8/		x 8/
ALBERTA EUB		x		x	x			x	
NOVA SCOTIA UARB		x	x	x	x			x	x
ONTARIO EB		x	x						
QUEBEC NGB	23/	x		x	x			x	

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**FOOTNOTES - TABLE 33 - AGENCY AUTHORITY OVER UTILITY SALE OF FACILITIES
AND PROCUREMENT**

- 1/ Yes, for natural gas facilities. Yes for electric facilities (public utility facilities) valued at \$50,000 or more if transmission facilities are involved. Yes for hydroelectric facilities. Qualifying Facilities are automatically exempt from FERC accounting requirements. Accounting requirements have been waived on a case by case basis for Affiliated Power Producers, Exempt Wholesale Generators, Independent Power Producers and others.
- 2/ Telephone, water and wastewater companies need Commission approval for transfer of certificate.
- 3/ Between two utilities.
- 4/ Board may disapprove transactions involving the whole or substantial part of utilities' assets or controlling interest of capital stock.
- 5/ Gas, electric, water and sewerage. New law, effective July 1992, requires SCC approval before acquisition or disposition of facilities in place of any public utility or municipality for the production, transmission or distribution of electric energy, gas, or the furnishing of sewerage facilities or water.
- 6/ If used in utility service.
- 7/ Accounting subject to review in compliance audits.
- 8/ May be required as cost control measure on major construction project.
- 9/ Affiliated interest transactions.
- 10/ Cost-plus contracts over \$100,000 must be filed 30 days before effective date.
- 11/ When outside financing is required and when new generating facilities are being considered.
- 12/ Yes, when lessee is a dominant carrier.
- 13/ Yes, as lessor of operating unit.
- 14/ Black Hills Power Light Company only.
- 15/ Audits in connection with rate case.
- 16/ Staff reviews proposed construction costs in connection with applications for issuance of securities and reviews equipment purchases in connection with plant additions during rate case studies.
- 17/ Agency does not regulate electric or gas utilities.
- 18/ Agency does not regulate electric or telephone utilities.
- 19/ For electric utilities, the requirement to establish a procurement policy was eliminated by Order No. 541, Final Rule and Policy Statement Eliminating Unnecessary Regulation, 59 FERC §61,122, published in 57 Fed. Reg. 21730 on May 22, 1992, appears in FERC Stats. and Regs. §30,943 (Order abolishes Part 50). For gas companies, the requirement to establish procurement policy was eliminated by Order No. 542, Deletion of Certain Outdated or Nonessential Regulations Pertaining to the Commission's Jurisdiction over Natural Gas, 59 FERC §61,123, published in 57 Fed. Reg. 21891 on May 26, 1992, appears in FERC Stats. and Regs. §30,945 (Order abolishes Part 160). Order No. 542-A Denying Rehearing, 59 FERC §61,383, published in 57 Fed. Reg. 29631 on July 6, 1992, appears in FERC Stats. and Regs. §30,946.
- 20/ Accounting requirements have been waived on a case-by-case basis for Independent Power Producers, Affiliated Power Producers, etc.
- 21/ Sale, transfer of assets, or merger must be reported within a reasonable time. If, in the next rate case, the transaction is found not in the public interest, its effect is disallowed in rates.
- 22/ For informational purposes only.
- 23/ Agency did not respond to request for update information; this data may not be current.

TABLE 34 - TRANSACTIONS WITH AFFILIATES

AGENCY	THE AGENCY PRESCRIBES SPECIAL REQUIREMENTS FOR TRANSACTIONS WITH AFFILIATES	
	ACCOUNTING	REPORTING
FCC and FERC	Prescribed system of accounts and annual report forms, maintenance/reporting of separate accounts for investments in, advances to and from, notes to and receivable from, accounts receivable from and payable to and notes payable to affiliates.	Same.
ALABAMA PSC 1/	Yes.	Investigation by staff.
ALASKA PUC 1/	Yes.	Yes.
ARIZONA CC	Same as FERC and FCC with additional records supporting jurisdictional differences as needed.	New rules certified in 1992 require reporting to the CC of all affiliate transactions. Certain transactions also require CC approval.
ARKANSAS PSC	Reviewed in rate cases.	Same.
CALIFORNIA PUC	Accounting requirements same as FERC and FCC. Standardized reports for all regulated electric, gas and telephone corporations.	File special reports annually; reasonableness of transaction considered. Specific guidelines for transfers. SB 1822 requires energy & telephone utilities to report all significant transactions with affiliates (QIR 92-08-008).
COLORADO PUC	Yes.	Affiliate transactions under continual review.
CONNECTICUT DPUC	Must be at cost or reasonable. Reviewed in rate cases.	Service contract charges from affiliates are reported in utilities' annual reports.
DELAWARE PSC 1/	Reasonableness of transactions is considered.	Reasonableness of transactions is considered.
DC PSC	No special requirements prescribed beyond USOA and GAAP.	No special requirements prescribed beyond USOA and GAAP.
FLORIDA PSC	Yes.	Yes.
HAWAII PUC	Yes. HRS 269-19.5	Must submit consolidated statement with explanation of transactions and basis of allocating common expenses.
IDaho PUC	Reviewed in rate cases.	No affiliated interest statute.
ILLINOIS CC	Approve all transactions except those specifically excluded by §7-101 of Public Utilities Act.	File reports relative to such transactions as Commission may prescribe.
INDIANA URC	Reviewed in rate cases.	Same as FERC and FCC.
IOWA UB 1/	Records of transactions must be preserved the same as for utility. Extraordinary documentation may be required; pricing subject to greater scrutiny.	Contracts w/affiliates must be filed annually.
KANSAS SCC 1/	Making adjustments for cases of ratemaking. (Statute requires full disclosure.)	Identify related companies in annual report, file contracts and keep SCC fully informed of transactions.
KENTUCKY PSC	Per system of accounts - reviewed in rate cases.	Same.
LOUISIANA PSC 1/	Insofar as certain transactions are concerned.	As part of annual report.
MAINE PUC	Only as occasion requires.	
MARYLAND PSC	Follow requirements of Uniform System of Accounts and report forms. These transactions with stand greater scrutiny.	
MASSACHUSETTS DPUC 1/	To extent they affect regulated utility adversely.	Requires abbreviated report from each affiliate.
MICHIGAN PSC	Per system of accounts.	In rate case filing requirements and annual reports.
MINNESOTA PUC 1/	Per system of accounts.	Part of Annual Report.
MISSISSIPPI PSC	Per system of accounts.	Contracts to be filed with Commission.
MISSOURI PSC	Case by case review.	Case by case review.
MONTANA PSC	Must be absolutely separate.	All transactions are kept separately.
NEBRASKA PSC	All transactions deemed necessary by PSC.	Same.
NEVADA PSC	Depends upon specific transactions.	Must submit contracts affecting NH utilities, i.e. contract for services rendered and/or charged to utility.
NEW HAMPSHIRE PUC	Depends upon specific transactions.	Description required in annual report plus supplemental reports if deemed necessary.
NEW JERSEY BPU 1/	Transaction must be reasonable and provide for elimination of unsupportable gains.	Yes.
NEW MEXICO PUC 1/	Yes.	Commission has authority under general powers to require any special reports to keep informed
NEW YORK PSC 1/	Companies must keep accounts so as to readily produce accurate statement of affiliate transactions.	Regulated companies annually report type, dollar amount and name of affiliate involved.
NORTH CAROLINA UC	Type and dollar amount of transaction between regulated company and affiliate must be identifiable in books.	Annual disclosure required including general description and dollars involved.
NORTH DAKOTA PSC	FERC and FCC	

TABLE 34 - TRANSACTIONS WITH AFFILIATES

AGENCY	THE AGENCY PRESCRIBES SPECIAL REQUIREMENTS FOR TRANSACTIONS WITH AFFILIATES	
	ACCOUNTING	REPORTING
OHIO PUC	Commission has authority but no standards have been adopted. Treated on a case-by-case basis.	Part of annual report. Commission has authority to require report.
OKLAHOMA CC OREGON PUC	As required by uniform system of accounts. Special acctg requirements to readily identify costs/revenues from affiliate transactions.	Same. Special reporting format prescribed by administrative rule.
PENNSYLVANIA PUC	PUC has authority to approve acquisition by utility of 5% or more voting stock of any corporation.	Requires Commission Order within 30 days.
RHODE ISLAND PUC	Yes.	Yes.
SOUTH CAROLINA PSC	All necessary steps to protect consumers.	Reports/other transactions filed/reviewed by PSC.
SOUTH DAKOTA PUC	Yes. 1/	Yes.
TEXAS PUC 1/	Yes.	PUC can require any special reports for info.
TEXAS RC	Same as FERC.	Same.
TEXAS NRCC	Reviewed in rate cases-Must be reasonable, necessary and no higher than charged to others	
UTAH PSC	No special provisions in law; PSC has authority under laws related to accounts/records.	Same. Transactions with affiliates are to be at arm's length.
VERMONT PSC	Yes. Same as FERC, FCC.	Yes. Same.
VIRGINIA SCC	Yes.	Yes.
WASHINGTON UTC	Keep records of cost of affiliate services and, if possible, cost of all items sold to utility.	Utility must file annual report regarding goods and services provided by or to utility.
WEST VIRGINIA	Prior consent required-reviewed for ratemaking.	As required by annual report.
WISCONSIN PSC	Highly extensive.	Yes. Case by case basis.
WYOMING PSC	Generally require separation of transactions in accounting records.	Case by case; part of annual reports.
PUERTO RICO PSC	1/	
CANADIAN RTC	No.	Quarterly report of material transactions, plus appropriate contracts/documentation/other data.
NATL ENERGY BD.	Per prescribed System of Accounts.	Yes - Reviewed in rate cases.
ALBERTA ELS	No special requirements established to date.	No special requirements established to date.
NOVA SCOTIA UARB	Subsidiaries are excluded.	Subsidiaries are excluded.
ONTARIO EB	Details of transactions filed-reviewed in rate case	Same.
QUEBEC HGB 1/	Reviewed in rate cases.	Monthly financial statements.

1/ Commission did not respond to request for update information; this data may not be current.
2/ The Commission has adopted specific cost allocation rules for some affiliate transactions.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO
FROM LARRY A. FRIMERMAN**

Q.1. What is the most important tool regulators need to protect the rate-payers?

A.1. The most important tool for regulators is the set of structural prohibitions which exists under PUHCA. These prevent the abuse of corporate form which could result in abusive self-dealing, cross-subsidization, or other anti-competitive or anti-consumer behavior. Section 11 (15 U.S.C. 79k) subsection (b) contains a prohibition on use of complex corporate forms in order to make it easier to detect and deflect abuses. Section 11 also contains a prohibition on diversification activities which are unrelated to the core business of the public utility system. Sections 10 and 11 contain a prohibition on acquisition of retail electric or gas service territories which are not contiguous or adjacent to other operating utility companies of the holding company. Each of these prohibitions has prevented anti-competitive, abusive, and risky behavior on the part of registered holding companies and exempt holding companies alike.

These prohibitions and structural protections contained within PUHCA are often overlooked by industry observers because utilities and others claim regulators have sufficient authority to disallow any inappropriate costs from rates, and because some claim there are sufficient intra-company separations to prevent costs or debt from one part of the holding company from affecting the operating utility subsidiary. These claims are not founded.

First, there currently are some regulatory gaps which could permit the pre-emption of State regulatory disallowances of costs for both goods and services and for power sales.

I have described the *Ohio Power* regulatory gap in my prepared statement. The net result of the *Ohio Power* decision is a pre-emption of the FERC's, and arguably State commissions' authority to disallow inappropriate costs for goods and services from wholesale (by the FERC) and retail (by the States) rates.

The *Mississippi Power & Light* regulatory gap is briefly described in my prepared statement. In this case, the net result is that State commissions are pre-empted from disallowing in retail rates certain power costs which have been allocated to various jurisdictions by the FERC as part of a multistage holding company intrasystem allocation formula. The dollar amounts for such actions could be staggering, as was the case with the Grand Gulf plant in *MP&L*.

Other gaps exist as well. Certain transactions such as diversification activities fall outside of the purview of State regulatory commissions with respect to multistage holding companies because of the Commerce Clause. Certain intra-state diversification activities may be reviewed by a State if the State has granted the public utilities commission statutory authority for pre-acquisition review of holding company transactions and approval authority for diversification activities. California is the only State that has a "little Holding Company Act" statute which comes close to protecting the consumers from diversification activities. While States conceivably could adopt such a statute, the likelihood of that happening in all 50 States in the near future is not quite as good as the likelihood of winning the lottery.

The Act also requires pre-acquisition review and prior approval for certain transactions. Some behaviors and actions do not readily lend themselves to effective post-hoc regulation. Many complex corporate structures, financial arrangements, or otherwise make it extremely difficult to detect and deflect inappropriate actions which could harm consumers or competitors. This prior review is not present under the Federal Power Act, and the FERC as configured is not equipped to handle the vast array of transactions which would have to be tracked if many restrictions are lifted and if prior review is not required. The FCC has planned to conduct financial audits of the Regional Bell Holding Companies once every 17 years. There have been countless instances of abuses that have been identified by auditors when there have been reviews conducted, but the activities had long caused their desired effects.

Premature repeal of PUHCA eliminates the anti-empire-building statute which serves as a primary barrier against market power abuses. In the congressional hearings from the 1920's until passage of PUHCA in 1935, witness after witness testified that such legislation was necessary to protect consumers and investors from the abusive and anti-competitive behavior of utility holding companies using corporate form and structure to unfair advantage.

Electric utility holding companies are aggressively consolidating in an effort to expand their customer reach in order to get a leg up on potential competitors in a pre-competitive sprint. Repeal of the integration requirement permits significant expansions into ever larger and non-adjacent geographical service areas by the largest investor-owned utility holding companies at the very time when we should be guarding against potentially anti-competitive behavior. Elimination of competitors at the current pace has the potential to restrict competition and could artificially inflate prices paid by consumers once retail competition is implemented. It is not hard to imagine the type and magnitude of the activities incumbent utility holding companies will engage in an effort to position themselves for maximum market reach.

S. 621 does not contain sufficient market power mitigation measures and consumer protections to replace the existing protections it eliminates by the premature repeal of PUHCA. Instead, it prospectively affirms the authority of the State commissions, for retail rates, and the FERC, for wholesale rates, to deny inappropriate and unreasonable costs for goods and services from being passed on to consumers.

However, this language neither prevents these potentially anti-competitive actions nor safeguards consumers from the results of such actions. First, there is no requirement that the FERC exercise its authority to prevent such abuses from occurring. Indeed, current FERC policies regarding market power mitigation are doing little to stem the tide of consolidation and concentration without repeal of PUHCA. Second, the language does not require the FERC to take certain actions to assure that existing market power be mitigated. Third, there is nothing which would prevent a State commission from being forced to choose between permitting a bankruptcy under its watch and allowing rate-payers to serve as underwriter for failed non-utility or new investment ventures.

Finally, there is no policy reason to free the large incumbent monopoly multistage holding companies from restrictions preventing takeovers of other companies' retail service territories and their associated monopoly customers prior to the onset of competition. During such time, there would be extremely few, if any, other enterprises which might have the financial wherewithal to acquire a large consolidated company's retail service territories or the legal approval to compete for that company's customers. Such a circumstance is a recipe for unfair competition, not a level playing field. Some registered holding companies are spending billions of dollars in the form of retained earnings and plunging the cash into risky or pre-competitive businesses in order to position themselves to "compete." As has been said many times, the industry has evolved in certain ways during the past 60 years, but human nature remains the same.

If retail choice were available for all customers, removal of the integration requirement along with the diversification ban would not be as problematic because then customers theoretically could choose another provider rather than be stuck absorbing unnecessary and unrelated costs. Yet, even after we transition to competition, PUHCA's prohibitions on use of complex corporate structures will remain necessary in order to prevent utilities from abusive self-dealing and cross-subsidies, thwarting competition and harming consumers.

In conclusion, it is unwise to prematurely repeal essential provisions of the Act such as the diversification ban and the integration requirement prior to the onset of retail choice for all consumers. It is further necessary to retain PUHCA's structural protections as well as to incorporate additional market power protections such as those contained in Representative Markey's H.R. 3782 from the 104th Congress.

Q.2. The FERC says it has the authority to reject acquisitions and mergers which are against the public interest or which upset market power. In your opinion, is this authority sufficient to protect consumers? Why or why not?

A.2. The FERC does have such authority granted under the Federal Power Act. In fact, for the first time in recent memory, the FERC has exercised this authority by rejecting conditions of the proposed Primergy merger on the grounds that it increased market power of the merged utilities. The FERC should be applauded for this action.

However, there have been many mergers approved for which the FERC has not made such a decision and where there appeared to be clear (but with slightly different circumstances) instances of utilities increasing market power, and where the merger was occurring to better position the merging companies to increase customer base prior to entering a competitively structured market. It is apparent that there should be additional clarity in the Federal Power Act regarding market concentration and affiliate relationships. For example, section 318 should be amended to prevent utilities or affiliates from using ownership or control of any resource to create or maintain a situation inconsistent with effective competition in any such market in which competition would benefit consumers. Under such

conditions, the FERC should order the public utility to sell assets to a non-affiliated company, should require specific arm's-length transactions, and/or should share access to assets on a comparable basis. Congress should direct the FERC to take any corrective action to eliminate undue concentration in any relevant geographic, product, or market.

On the other hand, PUHCA has also protected consumers from market power abuses by banning certain types of empire-building activities under sections 10 and 11. These activities should still be banned until there is effective competition to supplant the significant regulatory shortfalls which would undoubtedly occur if these activities are permitted.

Consumers can face very substantial risk when participants in a concentrated market diversify into unrelated or unregulated businesses in order to benefit the shareholders. For example, a holding company's use of all its retained earnings for investment in diversified activities could jeopardize the operating companies' ability to fund operations and growth. Congress should require and provide sufficient regulatory authorities to prohibit cross-subsidies between regulated and unregulated entities. Federal law should continue to bar utility diversification which threatens captive customers and fair competition. Federal law should prevent abusive or preferential affiliate transactions.

Q.3. The SEC has stated that it follows a policy of "watchful deference" to the FERC when making decisions on holding company acquisitions. What additional protection does PUHCA provide to prevent market power abuses, if the SEC already defers these decisions to the FERC?

A.3. As indicated above, PUHCA places a premium on preventing the conditions that lead to abuse. As practitioners, we are skeptical of regulators' ability to detect, prevent, and remedy abuses. After-the-fact detection is expensive, intrusive of those companies who are acting properly but still have to submit to the same "searches" that less benign companies face, and unreliable. The strength of PUHCA's structural limits is that it reduces the opportunities to abuse. The Federal Power Act has none of the structural protections that exist in PUHCA.

Moreover, the FERC in recent cases has stated that in reviewing mergers, it will not review effects upon retail customers, only upon wholesale customers. The FERC's conclusion is unlawful, because the entire purpose of the Federal Power Act was to protect the consumers. The FERC, however, says it will "defer" to States. Thus, we have the SEC deferring to the FERC, who then defers to States. NASUCA members have had the unnerving experience of being told by State commissions that they need not address a particular form of abuse because the SEC or the FERC will. Regulated utilities sometimes encourage this type of buck-passing, arguing to the SEC that the FERC will protect consumers and then arguing to the FERC that the FERC lacks the authority to do so.

The solution to this problem is a uniform set of market power standards, enforced by the agency who knows the most about the issues. Simply repealing PUHCA falls far short of that solution.

Q.4. SEC Rule 58 allows registered holding companies to acquire energy related subsidiaries without prior approval. Are you at all concerned over the effect Rule 58 will have on diversification and market power? Why or why not?

A.4. With respect to Rule 58, we believe the SEC erred by unilaterally promulgating a rule reinterpreting the Act to provide wholesale exemptions from SEC review for investments in a number of SEC-designated categories of non-utility ventures, in which multistage holding companies registered under the Act may now invest, in the absence of any congressional authorization.

We also believe the SEC violated the requirement of PUHCA which states that investments by multistage holding companies under PUHCA must be consistent with an integrated public utility system, when it promulgated a rule which automatically exempts a number of categories of non-utility ventures from PUHCA's integration requirement. This allows millions of dollars in unregulated investment, and fails to require the SEC's case-specific review or their prior authorization of non-utility ventures, thus effecting an administrative repeal of part of the integration requirement. Accordingly, both NASUCA and the Ohio Consumers' Counsel have appealed this rule.

DALE BUMPERS
ARIZONA

United States Senate

WASHINGTON, DC 20510-0401

ENERGY AND
NATURAL RESOURCES
SMALL BUSINESS

April 29, 1997

Honorable Alfonse M. D'Amato
Chairman
Committee on Banking, Housing, and
Urban Affairs
SD-534
Washington, D.C.

Dear Mr. Chairman:

I understand that the Banking Committee is holding a hearing today on S. 621, which would repeal the Public Utility Holding Company Act of 1935 (PUHCA). I am writing to express my strong objection to this legislation.

As you know, the Energy and Natural Resources Committee is currently examining issues associated with the restructuring that is currently underway within the electric utility industry. These issues, which include regulation of multistate utility holding companies, are complex and entirely interrelated. We need to be very careful to develop a thoughtful approach to restructuring which will benefit all consumers and treat utilities equitably.

On January 30 I introduced S. 237, the Electric Consumers Protection Act of 1997. S. 237 would require that all consumers have access to retail electric competition by 2003. The legislation contains a number of provisions designed to address the myriad of questions posed by restructuring. The bill includes language that would repeal PUHCA within one year of the date of enactment and replaces the Act with a variety of consumer protections that would remain in place until each holding company's customers gain the ability to choose their power supplier -- the ultimate consumer protection. S. 237 is currently pending in the Energy Committee.

I believe it would be unwise for Congress to repeal PUHCA on a stand-alone basis. It makes no sense to repeal a statute intended to protect millions of consumers without ensuring that the interests of these consumers are protected through alternative means. Practically every organization that represents consumers, including the Consumer Federation of America, the National Association of State Utility Consumer

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Advocates, the American Public Power Association, the National Rural Electric Cooperative Association and the National Association of Regulatory Utility Commissioners, opposes passage of stand-alone PUHCA repeal. Not surprisingly, the only entities supporting your legislation are the investor-owned utilities regulated pursuant to PUHCA.

PUHCA was enacted, in part, because state utility commissions did not have adequate authority to oversee the activities of utility companies operating in a multitude of states through separate subsidiaries. While certain elements of the Act have become outdated and the Securities and Exchange Commission has been less than fervent in protecting the interest of consumers, state commissions continue to lack the authority needed to oversee a utility company with operations in a multitude of states and throughout the world if PUHCA were repealed. In addition, PUHCA serves to limit the ability of utility companies to gain substantial market power in a manner that would inhibit competition among electric generators to the disadvantage of consumers.

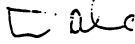
S. 621 fails to protect the captive customers of the multistate utility holding companies regulated under PUHCA. For instance, while the bill appears to give the Federal Energy Regulatory Commission broad access to holding company books and records, state commission access is more limited. The states could have a difficult time determining whether ratepayers are subsidizing nonregulated business activities. In addition, the bill fails to adequately resolve the Ohio Power issue by arguably grandfathering the thousands of existing contracts between holding company affiliates. If these contracts continue to be exempt from regulatory review, utility customers could be forced to pay for transactions at prices far in excess of market rates for a long period of time.

I do not oppose repealing PUHCA under any circumstance. What I do object to is Congress eliminating the Act without any thought given to the impact such action would have on electric utility

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restructuring and ultimately consumers. I hope that you will reconsider your plans to attempt to pass S. 621 before Congress enacts comprehensive electric restructuring legislation.

Sincerely,



Dale Eumpers

DB:rg

cc: Honorable Paul S. Sarbanes
Members Banking Committee

**STATEMENT OF THE CHEMICAL MANUFACTURERS ASSOCIATION
ON THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935**

APRIL 29, 1997

The Chemical Manufacturers Association (CMA) believes comprehensive Federal legislation is necessary in order for all the Nation's consumers to choose their electricity supplier. Since electricity flows in inter-state commerce, Federal legislation is necessary to facilitate a smooth transition to customer choice and to provide a consistent national framework. (See "Why Federal Legislation is Needed to Achieve Electricity Customer Choice," page 281.) Only Congress can pass legislation that assures a comprehensive approach to electricity industry restructuring and gives all consumers the right to choose their electricity supplier. Until all consumers have the freedom to choose their electricity supplier, consumer protection laws like the Public Utility Holding Company Act of 1935 (PUHCA) must be maintained.

The CMA is a nonprofit trade association whose member companies represent more than 90 percent of the productive capacity of basic industrial chemicals in the United States. Electricity is a key energy resource for the chemical industry, which purchases about 150-160 billion kWh per year, at a cost of \$5.6 billion. For some chemical manufacturers electricity can be as much as 80 percent of the cost of production. The ability of any entity to buy or sell electricity at negotiated rates is a critical CMA objective because electricity is the only commodity the chemical industry cannot purchase competitively. CMA believes that all electricity consumers should have the right to choose their electricity supplier and that all consumers will benefit from customer choice.

Under the traditional system in which electric utilities are regulated monopolies serving captive customers, prices are too high and great disparities exist among the prices utilities charge their industrial customers for electricity. These disparities even exist within the same State. In Texas, for example, a higher-price utility like El Paso Electric Company (as of January 1, 1993, the most recent data available to CMA) charged 5.73 cents per kWh for a typical industrial load whereas a lower-price utility like Southwestern Public Service Company charged 3.48 cents per kWh. Likewise, in Pennsylvania the disparity is reflected by the fact that Duquesne Light Company charged 6.85 cents per kWh compared with West Penn Power, located adjacent to Duquesne, which charged only 3.77 cents per kWh.

The most effective way to improve pricing and services and to eliminate such disparities is to require market-based competition. Only when customers can obtain their electricity from competing sources, with customer choice, will utilities be responsive to customer concerns. This will lead to improved service to all consumers at lower prices. The electricity industry's long-term planning process will also improve. Subject to market forces, generators will build only plants actually needed, and only at costs customers are willing to pay. Generators will bear the risks of technologies they own and operate, including risks due to changes in environmental laws. Environmental protection and energy efficiency will be achieved at a lower cost to society.

Market forces and customer choice, not Government mandates or monopoly control, should determine the supply, demand, and price. This principle should apply to electricity as it does to other energy resources. Electricity should compete on an equal basis with other energy resources in the marketplace. Buyers and sellers of electricity should be able to buy and sell under contract or in spot markets on mutually acceptable terms. This approach will serve our Nation's interests by strengthening the economy and increasing the United States' international competitiveness.

A CMA survey conducted in 1995 indicates that *customer choice at the retail level* would result in very substantial savings to our members. Just the survey sample alone—18 CMA member companies—expected to save an aggregate of more than \$216 million annually. Based on this data, the annual cost savings for total chemicals and allied products could range from about \$700 million to \$955 million.

Chemical companies increasingly compete in international markets on very tight margins. The only way a company can hope to remain competitive is by lowering its costs of production. Despite the fact that electricity can account for 50-80 percent of production costs, it is the only input that manufacturers are unable to competitively source. At a time when more and more companies are choosing to locate abroad or in other States, the cost of electricity represents an important factor of production for companies to consider when selecting where to locate and invest.

The long-term promise of customer choice in electricity is lower cost power for all consumers and a growing, more productive, domestic economy. According to a recent study which was conducted by the Citizens for a Sound Economy (CSE), a fully competitive electricity industry with universal customer choice could lower electricity bills by 30-40 percent. The typical American family will save about \$30 a month,

or \$360 a year. Customer choice means savings not only for consumers, but also for organizations like schools, hospitals, and local governments. This translates into additional cost savings for society.

Therefore, CMA strongly believes it is important to make wholesale and retail electricity generation markets competitive. Because of the natural monopoly characteristics of electricity transmission and distribution in the present market, continued regulation of these functions is necessary to protect consumers and to bring about customer choice of electricity supply.

Until the retail electricity markets are competitive, PUHCA must be maintained. Therefore, Congress must not remove any important consumer protection laws like PUHCA unless there is a competitive market established. Specifically, the repeal of PUHCA should *coincide* with the date when all consumers can purchase electricity competitively. As long as rate-payers remain captive customers of investor-owned utilities, PUHCA must be maintained to prevent rate-payer cross-subsidization.

Specifically, PUHCA requires the Securities and Exchange Commission (SEC) approval before holding companies can diversify their businesses and a prior SEC determination of whether this transaction is in consumers' interests. Therefore, the monopoly utility cannot bill rate-payers for the cost of other business activities. In a truly competitive electricity market, consumers could shop elsewhere for power if utilities increase rates in order to subsidize failed diversifications. However, reform or repeal of PUHCA without retail competition will allow registered electric holding companies to invest in other businesses using rate-payer dollars. Bad investments by the holding companies will result in higher electric rates for captive rate-payers. The potential exists for cross-subsidization between the businesses owned by the holding company to the disadvantage of the captive electricity consumers.

Generally, diversification has not tended to improve the financial performance of electric utilities. In fact, even though State regulators of exempt holding companies generally have some measure of authority over non-utility and holding company financing, this limited authority has not been sufficient to prevent several non-utility business failures from adversely affecting the financial viability and credit standing of the exempt holding company status. (See "Examples of Holding Company Diversification," page 282.)

The results of diversification failures by exempt holding companies suggest that when a holding company diversifies into business in which it has no particular expertise, the risks of diversification outweigh the benefits. Consumers generally do not enjoy any of the benefits when diversification is successful, and likely will suffer harm if diversification is unsuccessful. Extending this risk to registered holding company electric consumers is not in the public interest.

In addition, the unprecedented rate at which investor-owned electric utilities are merging punctuates the need for maintaining consumer protections until retail customer choice becomes reality. Utilities could use the holding company structure to create mega-utilities above and beyond the control of Federal and State regulators. The need for maintaining consumer protection laws applies even more so to residential rate-payers who individually can do little to impact electric utility practices.

Therefore, CMA opposes S. 621 and urges the Senate to review all the complex issues involved in electric utility restructuring. This review will highlight the fact that customer choice in electricity will benefit all consumers—industrial, commercial, and residential. In order for all consumers to have the right to choose their electricity supplier, Congress must enact comprehensive Federal legislation. (See "CMA Priorities for Federal Legislation," page 284.) Piecemeal legislation like repeal of PUHCA will delay the time when all consumers can choose their electricity supplier, unjustifiably maintain the Nation's last monopoly, and result in higher electric rates for captive rate-payers.

CMA looks forward to working with the Senate on all the issues raised by the electric utility restructuring debate.

Why Federal Legislation is Needed to Achieve Electricity Customer Choice

Under the traditional system in which electric utilities are regulated monopolies serving captive customers, prices are too high and great disparities exist among the prices utilities charge their customers for electricity. According to a recent study conducted by the Citizens for a Sound Economy (CSE), a fully competitive electricity industry with universal customer choice could lower electricity bills by 30–40 percent. The typical American family will save about \$30 a month, or \$360 a year.

A few States have already passed legislation that allows their citizens to shop for lower electricity rates. Other States are considering legislation that either grants citizens the right to choose their supplier or initiates a study regarding customer

choice; unfortunately some States have gone in the opposite direction and passed anti-competitive legislation. State initiatives for customer choice or retail competition should be encouraged. However, Congress must act so that *all* of the country's consumers in all States—residential, commercial, and industrial—can achieve customer choice. Here's why:

- Since electricity flows in inter-state commerce, Federal legislation is necessary to facilitate a smooth transition to customer choice and to provide a consistent national framework.
- Only Congress can pass Federal legislation that gives all consumers the right to choose their electricity supplier. Federal legislation will assure that *all* States implement customer choice in a consistent and timely manner that does not impede inter-state commerce.
- Regional electricity markets rarely correspond with State borders. Federal legislation would facilitate the necessary State cooperation for customer choice to benefit all consumers.
- If restructuring continues simply on a State-by-State basis, a "patchwork" of different State approaches will result. This would delay the inevitable and potentially cause some economic turmoil. Federal legislation would promote a much more competitive and efficient utility industry.
- Federal legislation should specify a "date certain" by when all States will have granted their citizens customer choice. A date certain is necessary in order to open the Nation's electricity markets to *all consumers* in *all States* in a timely manner.
- There should be Federal standards or guidelines of competition in the legislation for those States implementing customer choice. The standards should be clear and thorough enough to achieve a minimum national standard.
- Federal legislation should authorize the Federal Energy Regulatory Commission (FERC) to define transmission and distribution.
- Federal legislation should state clearly that non-mitigable "stranded costs" must be fairly shared by all the stakeholders as determined on a utility-by-utility basis. Congress must protect those customers exercising competitive options which are and have been available (e.g., self-generation). Customers should not be assigned any stranded cost responsibility related to reductions in the amount of electricity purchased from their local utility, since they do not currently nor have they historically paid these costs when exercising options such as self-generation.
- Only Congress is able to assure a comprehensive approach to electricity industry restructuring. Repeal or reform of the Public Utility Holding Company Act of 1935 (PUHCA) and the Public Utility Regulatory Policies Act of 1978 (PURPA), which include important consumer protections, must not be enacted piecemeal but must be part of comprehensive reform and timed to coincide with robust competition in the retail electricity market.
- There are certain issues which relate to the Power Marketing Administrations (PMA's), co-ops, etc., that can only be resolved in Federal legislation.

Examples of Holding Company Diversification

Dire predictions of diversification abuses are based on the experience of exempt holding companies which are not restricted by the Public Utility Holding Company Act. Indeed, costly diversification-related failures over recent years continue to adversely affect the financial position of utilities.

The most recent study of diversification in the electric industry was prepared by Edison Electric Institute (EEI). Based upon data contained in the study, which is entitled "Electric Utilities Ranked by 1992 Non-utility Earnings," we believe the following observations can be extracted:

- Electric utilities had invested over \$30 billion in non-utility assets by the end of 1992;
- The average return on non-utility assets for 1992 was approximately 1 percent;
- Only 5 of the 52 utilities reporting both assets and return achieved returns at or above the utility return; and
- Twenty-four of the 52 utility respondents achieved returns of less than 1 percent on assets.

Generally, diversification has not tended to improve the financial performance of electric utility systems. In fact, even though the State regulators of exempt holding companies generally have some measure of authority over non-utility and holding company financing, this limited authority has not been sufficient to prevent several non-utility business failures from adversely affecting the financial viability and the credit standing of the exempt holding company systems.

Examples¹ include:

- Pinnacle West Capital Corporation (PWCC), the corporate parent of Arizona Public Service Corporation, lost millions following the failure of Merabank (a savings and loan owned by Pinnacle), forcing PWCC to issue debt at the holding company level, serviced by the revenues of the operating utility subsidiary.
- Pacific Enterprises, the parent of Southern California Gas Company, diversified into discount drug and sports equipment retailing, and oil and gas operations. These businesses absorbed \$2 billion and brought the company to the edge of bankruptcy. In the first quarter of 1992, a \$475 million charge erased more than half of the company's \$650 million investment in Thrifty Corporation, a retail drug chain. This charge eliminated the company's retained earnings.
- Prior to 1990, FPL Group, Incorporated, the parent company of Florida Power & Light Company, acquired interests in cable television, insurance, and citrus fruit production. In 1990, diversification resulted in a staggering \$752 million write-down related to FPL Group's troubled 1986 acquisition of Colonial Penn Group (an insurance subsidiary) and three other non-utility businesses. This, in turn, led to a \$391 million year-end loss. Moreover, when combined with the income FPL Group could have earned on the \$116 million in cash that it spent to buy Colonial Penn plus the interest it paid to finance the purchase, the damage is even larger. It has been reported that "conservatively, FPL Group's diversification has cost shareholders and the company more than \$1.2 billion in shareholder's equity and lost income."² In mid-August 1991, FPL Group finally closed on the sale of Colonial Penn for \$150 million, which was \$415 million below FPL Group's 1985 purchase price.
- In the 1980's, TEP (Tucson Electric Power) invested in hotels, in car financing, real estate, a Tennessee bank, a California savings and loan, and other ventures. At least partially as a result of diversification, TEP lost \$82 million in 1989 and \$387 million in 1990 before stopping payments on certain major loans and contracts in early 1991. TEP's stock declined from a high of \$65 per share in 1986 to a close of \$6 at the end of 1990. Dividends on common stock were eliminated in early 1990 and dividends on preferred stock were scrapped in late 1990. In 1991 the stock dipped as low as \$3.50 per share. Six of TEP's creditors petitioned the Bankruptcy Court in Phoenix on July 16, 1991 to put TEP into an involuntary reorganization under Chapter 11 of the U.S. Bankruptcy Code and TEP has had to scramble to reach out-of-court arrangements with more than 150 creditors to avoid bankruptcy. Finally, a shareholder class action suit was filed claiming that TEP and several of its former officers and directors misrepresented or hid facts about TEP's financial situation. Apparently, a \$30 million settlement was worked out. In 1990, TEP's new management decided to sell off its non-utility businesses over a 4-year period, writing off \$105 million as expected losses. Charles Bayless, the President and Chief Executive since July 1990 "calls diversification a mistake for utilities. 'Stick to the knitting' is a phrase that crops up often when he discusses TEP's future."³
- CMS Energy Corporation (CMS) lost a total of \$817 million between June 1990 and June 1991 as a result of Michigan Public Service Commission's disallowance of more than \$1 billion of outlays by CMS's utility subsidiary, Consumers Power. CMS wanted to diversify within the energy field using about \$1.5 billion in assets. However, the Michigan regulators felt that CMS Chief William T. McCormick, Jr. would be violating a year-earlier pledge by his predecessor to use the \$1.5 billion in assets to return Consumers Power to financial health. The regulators held that the utility could not make a profit from its regulated activity and then use that profit as it saw fit, without regard to the risks to rate-payers, especially since the utility wanted the protection of rate-of-return regulation.
- Hawaiian Electric Industries, Incorporated, the parent of three Hawaiian utilities, was forced to write off its investment in two non-utility subsidiaries, one being the Hawaiian Insurance and Guarantee Company. As a result of the \$63.3 million write-off associated with the insurance business, both Moody's and Standard and Poor's placed the credit ratings of certain Hawaiian Electric securities under review for possible downgrade. Additional charges against 1993 earnings were recently announced to settle claims brought by State insurance regulators.

The results of diversification failures by exempt holding companies suggest that when a holding company diversifies into businesses in which it has no particular

¹ Examples from a brief filed with the SEC in 1995 by a local law firm.

² *Florida Trend*, vol. 43, no. 6, sec. 1, October 1991, p. 26.

³ *The Arizona Republic*, vol. 102, no. 190, sec. F, November 24, 1991, p. 1 (quoting Charles Bayless).

expertise, the risks of diversification outweigh the benefits. Consumers generally do not enjoy any of the benefits when diversification is successful, and likely will suffer harm if diversification is unsuccessful. Extending this risk to registered holding company electric consumers is not in the public interest.

CMA Priorities for Federal Legislation

- CMA strongly supports the designation of a "date certain" for implementation of customer choice for all consumers.
- CMA supports including Federal standards or guidelines of competition in the legislation for those States implementing customer choice. The standards should be clear and thorough enough to achieve a minimum national standard.
- An additional Federal standard of competition is needed in the legislation to state clearly that non-mitigable stranded costs must be fairly shared by all stakeholders as determined on a utility-by-utility basis.
- Customers exercising competitive options that are and have been available (e.g., self-generation) should not be assigned any stranded cost responsibility related to such options.
- Federal legislation should include a requirement for the mitigation of market power.
- Once customer choice is achieved, antitrust laws should apply to utility functions that are no longer regulated, just as they do to other businesses.
- Divestiture of generation assets should be stipulated as one legitimate means for achieving the elimination of self-dealing and mitigating stranded costs.
- CMA very strongly supports a comprehensive approach to the electricity industry restructuring. Repeal or reform of PUHCA and PURPA must not be enacted piecemeal but must be timed to coincide with robust competition in the retail electricity market.
- Based on recent studies and research, CMA believes customer choice could benefit the environment.

As an advocate of competition and customer choice, rather than monopoly control and regulation, CMA strongly supports the designation of a "date certain" for implementation of customer choice for all consumers. CMA believes that a date certain is necessary in order to open the Nation's electricity markets to all consumers in all States in a timely manner and to create a competitive, efficient utility industry. In addition, a date certain must guarantee that all classes of consumers (residential, commercial, and industrial) will simultaneously have the right to choose their electricity supplier. This will ensure that all consumers benefit from customer choice. The Federal Energy Regulatory Commission (FERC) should have fall-back authority to implement customer choice in States which do not implement customer choice. A date certain is necessary to assure that legislative requirements and changes have consistent timing so that there are no discriminatory practices during the transition period.

In addition, Federal legislation should specify Federal guidelines to provide the necessary framework for States to implement customer choice. These standards or guidelines should be clear and thorough enough to achieve a minimum national standard. Federal legislation should authorize the Federal Energy Regulatory Commission (FERC) to define transmission and distribution in order to avoid Federal/State jurisdictional disputes.

Federal legislation should state clearly that non-mitigable stranded costs must be fairly shared by all of the stakeholders as determined on a utility-by-utility basis. Stranded costs should not be collected in a manner that stifles customer choice, i.e., exit or entry fees for consumers choosing an alternative supplier. Customers exercising competitive options that are and have been available (e.g., self-generation) should not be assigned any stranded cost responsibility related to such options. In addition, States should determine utilities' legitimate utility stranded costs on a case-by-case basis, with appeals to the courts rather than the FERC.

Federal legislation should also include a requirement for the mitigation of market power. Once customer choice is achieved, antitrust laws should apply to utility functions that are no longer regulated, just as they do to other businesses. Market power should be reviewed by the Federal Trade Commission and Department of Justice using established methods.

Remedies including divestiture should be available to mitigate excess market power. Divestiture should be stipulated as one legitimate means for achieving the elimination of self-dealing and mitigating stranded costs. It is also important that electric utility activities, which continue as monopolies, i.e., transmission and distribution, need to remain under cost-of-service-based rate regulation.

Federal legislation should include provisions with regard to the Public Utility Holding Company Act of 1935 (PUHCA) and the Public Utility Regulatory Policy Act

of 1978 (PURPA). Because both contain important consumer protections, repeal or reform of PUHCA and PURPA must not be enacted piecemeal but must be timed to coincide with robust competition in the retail electricity market.

Critics of customer choice claim that it will harm the environment. However, credible studies indicate that customer choice will not harm air quality. Under the Clean Air Act Amendments of 1990, the U.S. Environmental Protection Agency (EPA) has authority to regulate the air we breathe regardless of changes to competitive forces in the utility sector.

According to recent research, including a major study by the FERC, a competitive energy services industry will expand the opportunities for new higher-efficiency generation units—driving out less efficient plants. Moreover, under the Clean Air Act, regulations governing new generation units will require utilities to use new lower-emission environmental technologies—resulting in a net benefit for the environment. In addition, other credible studies indicate that customer choice will promote the use of cleaner fuels.

Therefore, CMA believes customer choice could benefit the environment. Moreover, present laws, such as the Clean Air Act, clearly give the EPA the authority to take steps to ensure that public health and the environment are protected.

CMA Position on Customer Choice

Market forces and customer choice, not Government mandates or monopoly control, should determine supply, demand, and price. Electricity should compete on an equal basis with other energy resources in the marketplace. Buyers and sellers of electricity should be able to buy and sell under contract or in spot markets on mutually acceptable terms. This approach will serve our Nation's interests by strengthening the economy and increasing the international competitiveness of U.S. industry.

Only when all customers can obtain their electricity from competing sources, with customer choice, will utilities be responsive to customer concerns. This will lead to improved service for all consumers at lower prices. The electricity industry's long-term planning process will also improve. Subject to market forces, generators will build only plants actually needed, and only at costs customers are willing to pay. Generators will bear the risks of technologies they own and operate, including risks due to changes in environmental laws. Environmental protection and energy efficiency will be achieved at lower cost to society.

According to a recent study that was conducted by the Citizens for a Sound Economy (CSE), a fully competitive electricity industry with universal customer choice could lower electricity bills by 30–40 percent. The typical American family will save about \$30 a month, or \$360 a year.

Therefore, CMA strongly believes it is important to make both wholesale and retail electricity generation markets competitive. Because of the natural monopoly characteristics of electricity transmission and distribution in the present market, continued regulation of these functions is necessary to protect consumers and to bring about customer choice of electricity supply.

**STATEMENT OF
THE ELECTRICITY CONSUMERS RESOURCE COUNCIL [ELCON]**

APRIL 29, 1997

The Electricity Consumers Resource Council (ELCON) is very pleased to submit the following written statement on S. 621, the Public Utility Holding Company Act of 1997.

ELCON is a national association of industrial consumers of electricity. ELCON was organized in 1976. Our bylaws advocate Federal and State policies that assure an adequate, reliable, and efficient electricity supply at competitive prices. We have 36 members with major facilities in most of the 50 States. However, these companies represent 5 percent of all of the electricity consumed in the United States. They employ over 2 million workers, and collectively have annual revenues in excess of \$600 billion on assets valued over \$700 billion. A factsheet listing the ELCON membership is included with this testimony.

ELCON is also a founding member of the Consumers for Fair Competition, a broad-based coalition of consumer groups that support strong Federal oversight of utility holding companies. Along with this statement are a membership list of the coalition and its *Core Principles for Protection Against Market Power Abuses*.

Summary of Position

ELCON strongly supports the introduction of real competition into the electric industry. ELCON further supports the elimination of all laws and regulations that infringe on the rights of managers and owners of capital to use that capital productively in global and inter-state commerce. Yes, our members agree that even laws such as PUHCA, PURPA,¹ and major portions of the Federal Power Act should be reformed or repealed, but only in the appropriate context. The right context is after real competition has been introduced in this industry.

Our members understand the power of competition since they operate in highly competitive domestic and international markets. Real competition results in consumers seeking innovative goods and services at the very lowest prices associated with the quality of service they desire.

In a truly competitive market, producers are forced to: (1) produce efficiently, and (2) meet the competition in terms of what price they can charge their customers. If any producer were either inefficient or sought to charge more than the market-determined price, consumers would switch suppliers and buy from a competitor. The real magic of competition is that it also forces innovation. Even a successful supplier in today's marketplace with a large market share must continue to innovate to retain its customers.

Unfortunately today, we do not have a competitive electricity market. We do not even come close, notwithstanding the actions of several States to restructure their power sectors. Customers are captive to a regulated monopoly supplier of electricity. In fact, customers aren't given the courtesy of being called or treated like customers. They are mere "rate-payers"—a technical term for customers who cannot seek another supplier no matter how high the rates, how bad the service, or how obsolete the product. They do not have the opportunity or right to freely shop for these services and the result is a dreadful lack of innovation. If their local monopoly is efficient, and some certainly are, the customer benefits. However, if the local monopoly is, for any reason, inefficient, the customer has no choice but to pay the higher rates and accept the poorer quality of service.

A. Introduction

At issue before us today is the Public Utility Holding Company Act of 1935 and whether, in the names of deregulation, competition, or free markets, we can repeal this Act and give existing Registered Holding Companies (RHC's) greater discretion to acquire, merge with, or create new corporate entities which PUHCA would otherwise restrict or prohibit. Such repeal would also allow new holding company arrangements to be created in ways we probably cannot or do not want to imagine. After all, PUHCA was enacted to redress unprecedented market concentration and market power abuse in the utility industry.

We agree that truly competitive electric service suppliers should be allowed to compete in any line of business they desire. We are strong supporters of competition and believe that Government restrictions on mergers, acquisitions, and corporate structures should be minimal.

¹ The Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3(h) (1994).

But let's be candid. Today's electric utilities are not real businesses in the usual sense of the word. They are not yet competitive electric service suppliers. They are not subject to the full rewards (or pitfalls) of market discipline. They are regulated monopolies. Their brethren, which are Government sponsored, include: the U.S. Post Office, Air Traffic Controllers, and water and sewage companies. All have captive rate-payers. Some are privately owned and operated; some are publicly owned and operated. They are all the same—inefficient and unimaginative. One problem with monopolies is monopoly management is not motivated in the same way as managers of truly competitive businesses. Rather than operating under constant competitive pressures, ever seeking new ways to innovate or cut costs, managers of regulated monopolies operate under a much more lackadaisical "cost-plus" mentality. In many cases—such as high-cost electric utilities—it has become a cost-plus-plus situation.

In fact, by their own admission, high-cost electric utilities have accumulated almost \$200 billion in uneconomic assets and liabilities.² These costs are in excess of what market discipline would have allowed and are a direct measure of the inherently inefficient nature of monopolies. It is a growing travesty that many utilities—particularly RHC's—are using the huge cash flow, engendered by the fact that these uneconomic costs have severely inflated rates, to carry on a global buying binge of foreign utilities and assets.

Most fortunately, in the United Kingdom, the Trade and Industry Ministry has rebuffed an attempt by The Southern Company—an RHC—to take over National Power PLC, one of Britain's two largest fossil-fired generating companies. The concern was that such a consolidation was not in the public interest because it would harm the newly disaggregated competitive industry structure in existence since the government-owned monopoly utility was privatized in 1990. We believe that a very similar buying binge, by RHC's in the United States, would result from premature repeal of PUHCA, and severely frustrate attempts to increase competition in the U.S. power sector. Premature repeal of PUHCA does nothing but allow regulated multi-state monopolies to become bigger, unregulated monopolies, resulting in the anti-competitive consolidation of the electric industry.³

B. PUHCA Repeal: Before or After Real Competition?

Should PUHCA be repealed before or after real competition is introduced? Put another way: Should PUHCA be repealed before or after we get rid of the monopolies? Some argue that PUHCA is merely an arcane securities law designed for an industry and era that has long since gone. PUHCA repeal would also make it easier for all utilities—including RHC's—to better prepare themselves for competition, when and if that happens.

PUHCA is not a securities law; it is, first and foremost, a consumer protection law. What does it protect? It protects consumers from the self-serving interests of monopolists. The history of mankind is replete with examples of bad monopolies. To be accused of "monopolizing" something is rarely meant as a compliment. Yes, let's get rid of PUHCA; but don't do it until you first eliminate the monopolists!

Fortunately, the elimination of monopolists is beginning to happen, a change similar to that brought to bear on other previously regulated industries. Many State and Federal policymakers have correctly observed that market forces and new technologies have made obsolete the need to preserve the right of utilities to be the sole monopoly supplier of electricity. Many States are acting to introduce real customer choice including several pilot programs that are underway to demonstrate the efficacy of retail competition in electric products and services. At the Federal level, bills have been introduced in the House and Senate to accelerate and complement this process. But we're not there yet. In fact, we have a long way to go before the fruits of real competition will be enjoyed by every citizen and business in this country.

Unfortunately, repeal of PUHCA before a real competitive market in electricity is created probably would stop the limited competition that now is developing. Why? Because utilities could use the holding company structure to create mega-utilities above and beyond the control of Federal and State regulators.

We certainly do not mean to suggest that all mergers are bad. The fact simply is, we do not know today the difference between good and bad mergers.

The most compelling argument against the premature repeal of PUHCA is the uncertainty of how the emerging competitive marketplace is going to be structured.

² Edison Electric Institute, *Initial Comments of the Edison Electric Institute, Federal Energy Regulatory Commission, Docket No. RM94-7-000* ("Recovery of Stranded Cost by Public Utilities and Transmitting Utilities"), December 9, 1994, at 28.

³ Two additional appendices are included with this statement that: (1) document the failed diversification efforts of exempt holding companies that were allowed to engage in such mergers and acquisitions, and (2) respond to popular arguments—made primarily by registered holding companies—in defense of the repeal of PUHCA.

Only in the context of a clearly defined market structure can a reasonable and a safe determination of market power be made. We do not know at this time whether new mergers and acquisition by electric utilities—especially by some of the larger RHC's—are in the public interest because we do not know what the new industry will resemble. Issues, such as the need for Independent System Operators (ISO's)⁴ or power exchanges,⁵ the markets for ancillary services,⁶ and vertical disaggregation of the incumbent industry structured,⁷ are unresolved.

On May 7, 1996, ELCON filed comments with the Federal Energy Regulatory Commission (FERC) in response to the FERC's notice of inquiry on utility mergers. In those comments, we urged the FERC to adopt the *Merger Guidelines* of the U.S. Department of Justice (DOJ) and also the Federal Trade Commission (FTC). These guidelines stipulate, among other things, that a rebuttable presumption should be established that market power exists if: (1) one firm dominates the market with over 40 percent of market share; (2) there are less than five substantial, reasonably comparable competitors in any given market; and (3) entry is "difficult."

In order to ascertain whether a proposed merger or acquisition is in the public interest, i.e., there is no threat of abusive market or monopoly power, these guidelines must be applied in the context of a given market and the market's geography. But what are the "market" and "geography" at issue? Certainly, it is not the old regulated industry structure crumbling at our feet. It is a different set of markets that are now only slowly emerging. There are at least three possible scenarios for how this might play out.

- (1) There may be one national or North American electricity commodity market, which some believe could become the largest commodity market on earth.
- (2) Others suggest that three to nine regional markets should be established. Three regional markets could be set up in each of the three existing electrical interconnections; alternatively, nine markets would map the nine existing regional reliability councils established by the North American Electric Reliability Council.
- (3) A third scenario would result in 50 or so State-run market enclaves. This Balkanized framework would likely result if Congress ultimately fails to enact comprehensive legislation.

In each of these scenarios, the role and scope of ISO's, the market for ancillary services, and the size and operation of various power exchanges would all be different and would exist to serve different masters. The degree of antitrust concern with respect to market domination, the number of viable competitors, or barriers to entry would also vary from scenario to scenario. A market power problem in one scenario might not be a problem in another depending on the size of the market or the ability of the "I" in ISO to successfully mitigate potential market power abuse.

There are other equally important uncertainties. For example, how far are States willing to go to force utilities to operationally unbundle their systems, or to mandate the divestiture of generation from the regulated delivery functions of the traditional utility? We do not have the answer now, but because of all of these concerns, the DOJ/FTC *Merger Guidelines* and other tests of market power may be seriously ineffective in judging the merits of any merger proposal.

As a result of this tremendous uncertainty, we question the motives behind recent utility merger proposals and attempts to more easily facilitate mergers and acquisitions which the complete repeal of PUHCA would accomplish. Repealing PUHCA in advance of real customer choice would allow utilities to use captive rate-payers as anchors in speculative diversification efforts. Large utility monopolies will consolidate into larger utility monopolies and these entities would be subject to less regulatory oversight to protect consumers.

Both of these actions should be opposed. Both actions are overt attempts to lock in market power—really, monopoly power—to ward off oncoming competition. These self-proclaimed attempts to "prepare for competition" are nothing less than attempts by incumbent monopolies to shield themselves from competition. Congress should

⁴See Electricity Consumers Resource Council, *Profiles on Electricity Issues: Independent System Operators*, No. 18, March 1997.

⁵See Pacific Gas and Electric Company, San Diego Gas & Electric Company, and Southern California Edison Company, *Joint Application for Authority to Sell Electric Energy at Market-based Rates Using a Power Exchange (PX)*, Federal Energy Regulatory Commission Docket No. ER96-1663-000, April 29, 1996.

⁶See Eric Hirst and Brendan Kirby, *Electric-Power Ancillary Services*, Oak Ridge National Laboratory, Energy Division, ORNL/CON-426, 1996.

⁷For example, California's three largest utilities are each divesting 50 percent of their fossil generation. In Massachusetts, the State's largest utility, Massachusetts Electric Company, has agreed to sell or spin off all of its generating assets.

not fall for this. Thus, as a pre-condition to the repeal or reform of PUHCA, we urge one of two things.

First, enact comprehensive legislation that would enable all consumers to freely choose their electricity suppliers, thus ensuring a competitive industry structure by date certain. In that event, the market will provide the consumer protection now intended by PUHCA.

The alternative, though inferior to customer choice, is to strengthen S. 621 and ensure that adequate regulatory safeguards are in place to protect consumers from any undue exercise in monopoly power that the repeal of PUHCA would enable.

C. Adequate Consumer Protection Requires Amending the Federal Power Act

Let's discuss what needs to be done to ensure adequate regulatory oversight in the absence of real competition or customer choice and in an environment in which big, huge, small, and tiny electric monopolies continue to exist. Repeal of PUHCA will require amending the Federal Power Act (FPA) to strengthen the ability of Federal and State regulatory authorities to access the books and records of unregulated affiliated companies of registered holding company systems who may have transactions with any Federal Energy Regulatory Commission and/or State jurisdictional regulated affiliate. This may appear complicated, and it is. The concern here is the potential for self-dealing, unfair cost allocations, and for cross-subsidization between regulated and unregulated affiliates to the detriment of the captive rate-payers of the regulated affiliate. This concern is heightened by the ability of holding companies to erect complex corporate structures with the explicit intent of frustrating regulatory oversight and competition.

No captive rate-payers of a regulated entity—whether they be residential, small business, or large industrial consumers—should ever be forced to subsidize the unregulated, diversified investments of the regulated entity's parent company or any unregulated affiliate. All transactions between unregulated and regulated affiliates must be at arm's length and subject to regulatory oversight. For starters, we recommend the following changes to the FPA.

First, the FERC's access to books and records of utility affiliates under the FPA is more limited than the SEC's under PUHCA. This problem has also been identified by the Securities and Exchange Commission in their report, "The Regulation of Public Utility Holding Companies."⁸ Audit authority is an essential tool of regulation, but the FERC does not have the power, under the FPA, to use its investigative powers to effectively monitor every company or affiliate in a registered system. Furthermore, the FERC cannot use its investigative powers solely for the purpose of assisting a State regulator in setting rates or enforcing a State regulatory statute. S. 621 must include the enumeration of both Federal and State auditing authorities.

Second, States should be afforded the same level of access to utility holding company books and records as Federal regulators, and we believe the access powers of the FERC should also be enhanced. S. 621 severely restricts State authority in a fashion that would inevitably hinder effective State oversight. For example, requiring States to identify such books and records "in reasonable detail in a proceeding before the State commission," and further constraining States with additional qualifications, will not produce the intended results. In addition, the FPA does not now give the FERC the authority to provide the books and records of its jurisdictional utilities to State commissions that would otherwise be unable to access such books and records for out-of-state affiliates of its jurisdictional utilities.⁹ The SEC has also identified this shortcoming in their report.¹⁰ It is also extremely important that protections at the State level be in place *before* PUHCA is repealed. Legislation must ensure that State regulatory commissions have the resources to fully and effectively exercise these authorities. We recommend that the bill be amended to correct each of these problems, especially the right of States to access books and records outside their borders, and a requirement that State authorities be strengthened and enforceable before the repeal of PUHCA takes effect.

Concerning affiliate transactions, a simple transfer of PUHCA section 13 powers from the SEC to the FERC may not be sufficient to plug the so-called "Ohio Power" gap; the FERC must be given additional powers to review affiliate transactions.¹¹ Further, the "cost" standard in section 13 may not be the correct standard for re-

⁸ U.S. Securities and Exchange Commission, "The Regulation of Public Utility Holding Companies," Division of Investment Management, June 1995, at 139, (*SEC Report*).

⁹ FPA Section 301(c) gives the FERC the authority to access this information.

¹⁰ *SEC Report* at 138-8.

¹¹ *SEC Report* at 140-41. See *Ohio Power Company v. FERC*, 954 F.2d 779, 782-86 (D.C. Cir., cert. denied, 113 S.Ct. 483 (1992)).

viewing affiliate transactions if such authority is to be passed to the FERC which, under the FPA, has adopted an alternative, market-based pricing standard for affiliate transactions.¹²

Merely transferring section 13 powers to the FERC will not affect the *Mississippi Power & Light* doctrine, and important questions remain about the extent to which Federal review of affiliate transactions insulates them from State review.¹³ S. 621 should be strengthened in order to provide sufficient guidance on what constitutes an improper affiliate transaction. Congress should establish very clear standards on affiliate transactions in order to ensure that implementation by the FERC will effectively preclude any potential for self-dealing, for unfair cost allocations, and/or for cross-subsidization. States should also be given clear authority to review affiliate contracts—up-front—to assure that all anti-competitive issues are adequately addressed before they become a problem.

Finally, we note that there is no affirmative finding in support of competition in any form—in fact, the word “competition” is never once used in the bill. As written, S. 621 presumes the continuation of monopolies with captive rate-payers who are charged “rates” on a take-it-or-leave-it basis, not “prices” in a competitive marketplace. The net effect of this omission would be to federally sanction the unregulation of currently regulated monopolies.

D. The Real Solution is Real Competition

The regulatory “fixes” we have proposed are difficult to define and will be difficult to implement. Further, they miss the real problem. Our frustration with regulation is that regulators cannot adequately police the transactions between regulated and unregulated affiliates. Regulators are routinely overwhelmed by the resources regulated entities are able to employ—due to their sizable cash flows—to frustrate the best intended efforts in regulatory oversight.

The real problem is the fact that electric customers do not have choice. Customers are captive and thus subject to exploitation by monopolists. The solution is not to keep customers captive and allow RHC's or other utilities with monopoly power to diversify into highly speculative activities unrelated to their electric business. The solution is to provide customers with a choice. Customer choice is a right that every American citizen and business deserves. Even the Federal Government could cut its chronic budget deficit if all Federal agencies were allowed to competitively procure electricity.

Customer choice works without harming reliability. Experience in foreign countries, where choice is allowed, clearly demonstrates this fact. Customer choice will also greatly improve the resource planning process by removing any incentive to invest in uneconomic assets. As in any other unregulated industry, those who make investments assume risk—not captive customers or rate-payers. Customer choice will guarantee that innovative products and services, actually wanted or needed by consumers, will be forthcoming. That's a huge improvement from today's world.

Once customers have choice, the market can and will be able to protect customers from the market power of any individual supplier. Customers who do not want to pay exorbitant prices simply vote with their dollars and buy from another supplier. Then, and only then, will consumers be willing to discuss the amendment, if not the outright elimination, of PUHCA. Consumers want change. They want competition. Sadly, competition is not even close to being a reality in the current electric industry, and S. 621 is silent on the issue.

Rather than falling for the monopolist's argument that it is unfair to restrict RHC's from making the same mistakes that exempt holding companies have been allowed to make, we believe it is unfair to keep rate-payers captive to utilities that err. A utility's captive rate-payers—unlike its stockholders—are unwilling partners in diversification efforts. Stockholders who become disenchanted with the diversification decisions can sell their shares and leave. Rate-payers cannot; they're stuck.

In conclusion, we repeat, *it is time for customer choice in electricity*. Then, and only then, can consumers protect themselves from utility errors brought about by failed diversifications and other management indiscretions.

¹²SEC Report at 141. See Opinion 133, *Public Service Co. of New Mexico*, 17 FERC ¶61,123 (1981), *reh'g denied*, 18 FERC ¶61,036 (1982), *aff'd*, 832 F.2d. 1201 (10th Cir. 1987).

¹³*Id.* See *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354 (1988). Under the *Mississippi Power & Light* doctrine, “State regulators setting retail rates have no authority to question the prudence of a FERC-approved allocation of capacity purchases of electric energy among affiliates of a registered holding company system.” *Cincinnati Gas & Electric Company and PSI Energy, Inc.*, 64 FERC ¶61,237 (1993).

Who We Are . . .

ELCON is an association of large industrial consumers of electricity. Our members have facilities in most of the 50 States and in many foreign countries. These companies produce a wide range of products, including aluminum, steel, petroleum, chemicals, industrial gases, glass, motor vehicles, electronics, textiles, paper products, and food. Our 35 member companies consume almost 6 percent of all of the electricity in the United States. These companies require an adequate and reliable supply of electricity at competitive prices.

Member Companies

A.E. Staley Manufacturing Company	Ford Motor Company
Ag Processing Inc.	General Motors Corporation
Alcan Aluminum Corporation	Honda
AlliedSignal Engineered Materials	Intel Corporation
Amoco Corporation	LTV Steel Company
Anheuser-Busch Companies, Inc.	Monsanto Chemical Company
Armco Inc.	Occidental Chemical Corporation
Bethlehem Steel Corporation	ORMET Corporation
BOC Gases	Owens-Corning
Bristol-Myers Squibb	Praxair, Inc.
Cargill/North Star Steel	Procter & Gamble Paper Products Co.
Central Soya Company, Inc.	Republic Engineered Steels, Inc.
The Chevron Companies	Shell Oil Products
Cleveland-Cliffs Inc.	Texaco
Cone Mills Corporation	The Timken Company
Dow Chemical, U.S.A.	WCI Steel, Inc.
Eastman Chemical Company	Whirlpool Corporation
E.I. du Pont de Nemours & Co.	

APPENDIX A

CONSUMERS FOR FAIR COMPETITION

Core Principles for Protection Against Market Power Abuses

In 1935, Congress enacted the Public Utility Holding Company Act (PUHCA) in order to reduce and constrain the exercise of market power in the investor-owned electric and natural gas utility industries and to prevent abusive stock and business practices of far-flung investor-owned electric and gas utility holding companies.

The electric utility industry has changed significantly since 1935, and more profound changes loom on the horizon. While PUHCA has protected consumers in part by restraining market power, the market dominance of utilities still continues to threaten captive consumers and the emerging competitive market.

Mergers, barriers to entry, self-dealing, and cross-subsidies can be used to stifle competition. An efficient and competitive electric industry will not develop if the market consolidates to a handful of large players or if certain participants are allowed to engage in discriminatory actions.

Satisfying PUHCA's underlying purposes—the mitigation of market power and prevention of inter-affiliate transactions and utility diversifications which threaten captive rate-payers—are the best possible policy options for ensuring a truly competitive marketplace. The administration of PUHCA does have clear limitations. In a potential transition to a competitive electric marketplace, the implementation of specific consumer-oriented reforms will be necessary. Most importantly, Congress should direct the Federal Energy Regulatory Commission (FERC) to assume the authority of the Securities and Exchange Commission under PUHCA to protect consumers from market power abuses. In considering legislation affecting the structure of the electric industry, including PUHCA repeal or reform, Congress must address the following specific issues:

- **Mergers and Acquisitions.** When two competitors merge, one less participant competes in the marketplace. In addition to preserving the existing authority to address utility mergers at the Department of Justice and Federal Trade Commission, Congress should direct the FERC to reject or condition, as appropriate, any proposed merger including gas and electric combinations, or acquisition that creates, exacerbates, or maintains market power in any relevant geographic, product, or service market. The FERC should reject any merger if the anticipated consumer benefits can be achieved through other means.

- **Market Concentration.** Undue dominance by a player in any geographic or product market will frustrate and eventually eliminate effective competition. Congress should direct the FERC to take any corrective action to eliminate undue concentration in any relevant geographic, product, or service market.
- **Utility Diversification.** Consumers can face substantial risk when participants in a concentrated market diversify into unrelated or nonregulated businesses to benefit the shareholders. Congress should require and provide sufficient regulatory authorities to prohibit cross-subsidies between regulated and nonregulated entities. Federal law should bar utility diversification that threatens captive customers (i.e., generation and transmission dependent consumers, consumers served by distribution systems that are not subject to competition) and fair competition, and prevent abusive or preferential affiliate transactions. Any definition of cross-subsidization should capture the full value of tangible and intangible assets transferred between regulated and nonregulated entities. These protections should be waived when vibrant structural competition exists in relevant markets.
- **Transmission.** Even with the FERC's expanded transmission access authority granted under the Energy Policy Act of 1992, the potential exists for transmission owners to use their control of essential facilities to favor their own power sales. Moreover, payment of successive transmission fees for use of individual utility transmission facilities within a given geographic market can create economic inefficiencies and market distortions. To ensure implementation of competitive power markets and to check market abuse, Congress should direct the FERC to develop guidelines for and require mechanisms to ensure the independent control, operation, and planning of the grid and efficiently functioning nondiscriminatory and geographically broad independent transmission service.
- **Reliability.** All market participants have responsibility to ensure effective functioning of a reliable and competitive electricity market. The FERC must ensure that not one market participant is able to avoid the responsibilities for reliability or to cloak anti-competitive activity in the guise of reliability concerns. The FERC should establish and enforce nondiscriminatory rules and guidelines for ensuring reliability and for ensuring that each market participant fulfills its contractual obligations, particularly in cases where a market participant attempts to manipulate operating procedures and guidelines so as to unduly influence the market clearing price.
- **FERC Review of Wholesale Electric Rates.** The role of the FERC in reviewing and setting wholesale electric rates will be vastly reduced in a vibrant competitive market. However, given the anticipated continued concentration and potential monopoly control of products and services in certain markets, and in certain time periods, it is important for the FERC to retain its authority to regulate effectively rates—either on its own initiative or upon a complaint—where the potential for market power abuse continues.
- **Access to Information.** To assist the efficient operation of a competitive market, Congress should: (1) provide the Federal and State regulators with complete and timely access to relevant corporate books and records to uncover and prevent discriminatory transfer pricing; (2) provide Federal and State regulators with audit authority regardless of the corporation's location; (3) direct the appropriate regulatory bodies to provide competitors with comparable access to relevant customer information; (4) require the FERC to make all relevant transmission use and pricing information available to all interested parties on a real-time basis; (5) give the FERC the authority to require the unregulated electric utility affiliates to disclose their affiliations; and (6) require that State regulatory authorities provide adequate protection for utility customer proprietary information and data. Utility information on individual customer sites should not be shared with affiliates in the aggregate unless such information is made available to competitors and individual site data should not be divulged unless the customer has provided knowledgeable written consent.

Signatories of the Core Principles for Protection Against Market Power Abuses

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APPENDIX B

Examples of Holding Company Diversification

Dire predictions of diversification abuses have their precedent in the experience of exempt holding companies which are not restricted by PUHCA. Indeed, the costly diversification-related failures over recent years continue to adversely affect the financial position of utilities.

The most recent study of diversification in the electric industry was prepared by Edison Electric Institute (EEI). Based upon data contained in studies, which are entitled "Electric Utilities Ranked by 1992 Non-utility Earnings" and "Electric Utilities Ranked by 1992 Non-utility Assets," we believe the following observations can be extracted:

- Electric utilities had invested over \$30 billion in non-utility assets by the end of 1992;
- The average return on non-utility assets for 1992 was approximately 1 percent;
- Only 5 of the 52 utilities reporting both assets and return achieved returns at or above the utility return; and
- Twenty-four of the 52 respondents achieved returns of less than 1 percent on assets.

We believe this data speaks volumes concerning the potential risks of unbridled holding company diversification absent PUHCA. Generally, diversification has not tended to improve the financial performance of electric utility systems. For every moderate winner, there has been a major loser.

In fact, even though State regulators of exempt holding companies generally have some measure of authority over the non-utility and holding company financing, this limited authority has not been sufficient to prevent several non-utility businesses

failures from adversely affecting the financial viability and credit standing of the exempt holding company systems. Examples include:

- Pinnacle West Capital Corporation (PWCC), the corporate parent of Arizona Public Service Corporation, lost millions following the failure of Merabank (a savings and loan owned by Pinnacle), forcing PWCC to issue debt at the holding company level, serviced by the revenues of the operating utility subsidiary.
- Pacific Enterprises, the parent of Southern California Gas Company, diversified into discount drug and sports equipment retailing, and oil and gas operations. These businesses absorbed \$2 billion and brought the company to the edge of bankruptcy. In the first quarter of 1992, a \$475 million charge erased more than half of the company's \$650 million investment in Thrifty Corporation, a retail drug chain. This charge eliminated the company's retained earnings.
- Prior to 1990, FPL Group, Incorporated, the parent company of Florida Power & Light Company, acquired interests in cable television, insurance, and citrus fruit production. In 1990, diversification resulted in a staggering \$752 million write-down related to FPL Group's troubled 1986 acquisition of Colonial Penn Group (an insurance subsidiary) and three other non-utility businesses. This, in turn, led to a \$391 million year-end loss. Moreover, when combined with the income FPL Group could have earned on the \$116 million in cash that it spent to buy Colonial Penn plus the interest it paid to finance the purchase, the damage is even larger. It has been reported that "conservatively, FPL Group's diversification has cost shareholders and the company more than \$1.2 billion in shareholder's equity and lost income."¹⁴ In mid-August 1991, FPL Group finally closed on the sale of Colonial Penn for a paltry \$150 million.¹⁵ This was \$415 million below FPL Group's 1985 purchase price.
- Tuscon Electric Power's (TEP) fall was spectacular. In the 1980's, TEP invested in hotels, car financing, real estate, a Tennessee bank, a California savings and loan, and other ventures. At least partially as a result of diversification, TEP lost \$82 million in 1989 and \$387 million in 1990 before stopping payments on certain major loans and contracts in early 1991. TEP's stock crashed from a high of \$65 per share in 1986 to a close of \$6 at the end of 1990. In 1991 the stock dipped as low as \$3.50 per share. Dividends on common stock were eliminated in early 1990 and dividends on preferred stock were scrapped in late 1990. Six of TEP's creditors petitioned the Bankruptcy Court in Phoenix, Arizona, on July 16, 1991 to put TEP into an involuntary reorganization under Chapter 11 of the U.S. Bankruptcy Code and TEP has had to scramble to reach out-of-court arrangements with more than 150 creditors to avoid bankruptcy. Finally, a shareholder class action suit was filed claiming that TEP and several of its former officers and directors misrepresented or hid facts about TEP's financial situation. Apparently, a \$30 million settlement was worked out. In 1990, TEP's new management decided to sell off its non-utility businesses over a 4-year period, writing off \$105 million as expected losses. Charles Bayless, the President and Chief Executive since July 1990 "calls diversification a mistake for utilities. 'Stick to the knitting' is a phrase that crops up often when he discusses TEP's future."¹⁶
- CMS Energy Corporation (CMS) lost a total of \$817 million between June 1990 and June 1991 as a result of Michigan Public Service Commission's disallowance of more than \$1 billion of outlays by CMS's utility subsidiary, Consumers Power. CMS wanted to diversify within the energy field using about \$1.5 billion in assets. However, the Michigan regulators felt that CMS Chief William T. McCormick, Jr. would be violating a year-earlier pledge by his predecessor to use the \$1.5 billion in assets to return Consumers Power to financial health. The regulators held that the utility could not make a profit from its regulated activity and then use that profit as it saw fit, without regard to the risks to rate-payers, especially since the utility wanted the protection of rate-of-return regulation.
- Hawaiian Electric Industries, Incorporated, the parent of three Hawaiian utilities, was forced to write off its investment in two non-utility subsidiaries, one being the Hawaiian Insurance and Guarantee Company. As a result of the \$63.3 million write-off associated with the insurance business, both Moody's and Standard and Poor's placed the credit ratings of certain Hawaiian Electric securities under review for possible downgrade. Additional charges against 1993 earnings were recently announced to settle claims brought by State insurance regulators.

¹⁴ *Florida Trend*, vol. 34, no. 6, sec. 1, October 1991, p. 26. "For comparison, Federal banking regulators have estimated CentTrust Savings, one of the largest—if not the largest—U.S. bank failures, will cost taxpayers \$2 billion." *Id.*

¹⁵ UPI International, August 17, 1991, states that Colonial Penn actually sold for \$130 million.

¹⁶ *The Arizona Republic*, vol. 102, no. 190, sec. F, November 24, 1991, p. 1 (quoting Charles Bayless).

The results of diversification failures by exempt holding companies suggest that when holding companies diversify into businesses in which they have no particular expertise, the risks of diversification outweigh the benefits. Consumers generally do not enjoy any of the benefits when diversification is successful, and likely will suffer harm if diversification is unsuccessful. Extending this risk to registered holding company electric consumers simply is not in the public interest.

APPENDIX C

Responses to PUHCA Repeal Arguments

1. *It is NOT true that only 15 companies are still subject to PUHCA.*

- All companies that own, operate, or acquire electric and some gas utilities are subject to regulation under PUHCA.
- Only 15 utility holding companies—each with a number of operating utilities—may currently be subject to *registration* under PUHCA, but *all exempt utility holding companies* are subject to PUHCA and are required to meet very strict standards in order to maintain their exemptions.
- These exemptions most often require the utilities to confine their utility operations primarily to a *single State*. This ensures that State utility commissions can regulate the utility affiliate operations and diversification, *that captive rate-payers do not subsidize such affiliate operations*, and also that the many abuses among holding company affiliates that occurred in the 1920's and 1930's do not reoccur. The SEC is responsible for this oversight of the multi-state registered holding companies, since no single State can regulate their activities.
- Non-utility businesses are also subject to PUHCA and are restricted by it in their acquisitions of utilities.
- If PUHCA were repealed, not only the current 15 registered holding companies, but *every other utility in the country*, as well as *non-utility businesses*, would be free to acquire widely dispersed utility affiliates and engage in other multi-state activities and practices that in the 1920's and 1930's were found harmful to consumers and investors because States were unable to regulate those practices.
- If PUHCA were repealed, the exempt holding companies would no longer have to maintain their exemptions by confining their utility operations primarily to a single State. State commissions would then not only fail to have control over the *current 15* registered multi-state holding companies and their affiliates, they could *also* lose control over existing exempt holding companies, that would be free, in the absence of PUHCA, to engage in unconditioned inter-state and foreign acquisitions and operations.

2. *It is appropriate for registered holding companies to have more restrictions on their activities because their multi-state activities prevent any single State from being able to control all their affiliate activities.*

- The registered holding companies have mounted a strong campaign complaining of unfair discrimination against them, *vis-à-vis* the exempt holding companies. The registered holding companies *should* be treated differently because they are different: Their activities extend beyond the jurisdiction of any single State commission and they have large captive-customer service territories.
- Moreover, the two new exemptions from PUHCA added in 1992, Exempt Wholesale Generators (EWG's) and Foreign Utility Companies (FUCO's), already give both registered and exempt holding companies (as well as non-utilities) freedom to invest in wholesale generators located throughout the United States and to invest in wholesale generation, transmission, and distribution facilities located throughout the world, *as long as the State commissions regulating their U.S. utility affiliates have the ability and intention to protect captive rate-payers*. If PUHCA were simply repealed, this protection would vanish.
- In addition, it should be noted that, in terms of foreign acquisitions, the registered companies appear to be among the most active U.S. companies involved. For example, the SEC has just recently allowed the Southern Company, which already owns a distribution utility in the United Kingdom among other foreign utilities, to invest *100 percent* of its profits (retained earnings) in foreign utilities. It therefore does not appear that registered holding companies have encountered any undue disadvantage in foreign development, despite the fact that this was *one of the concerns of the 1935 Act—that captive rate-payers in the United States would subsidize risky foreign utility investments*.

3. *The number of registered holding companies is growing.*

- A few years ago, there were only 13 registered companies; today, there are 15. Moreover, there are several new proposed mergers before the FERC in which

the applicants state that the merged company will become a registered holding company.

- The *increase* in registered holding companies indicates: (1) that a multi-state merger trend is in progress, exacerbating the existing problem of lack of State commission control over multi-state holding companies, and (2) that the merging companies do not consider the current restrictions associated with being a registered holding company to outweigh the benefits of such status.

4. *There is no real support for the statement that the abuses of the 1920's and 1930's cannot recur.*

- PUHCA has prevented their recurrence to date. Once it is gone, many of the same abuses may resurface. Human nature—and the propensity for a monopolist to abuse its monopoly power—has *not* changed since the 1920's and 1930's.
- For example, even registered holding companies now must confine their merger partners to nearby States. If PUHCA is repealed, mergers can occur between geographically disparate utilities. This happened to be one of the central concerns in 1935 when the growth and the extension of holding companies bore "no relation to economy of management and operation or the integration and coordination of related operating properties."
- Another of the chief concerns of the original 1935 Act was the double-leveraging by upstream holding companies, controlled by small numbers of investors, and based on the operating company assets, that ultimately led to huge losses for utility investors. Under PUHCA, double-leveraging (double-borrowing against the same assets by means of loan or bond proceeds in a holding company being invested as equity in a lower-tier company, which had its own debt) was eliminated. Although the SEC contends that investors now have the ability to detect such leveraging, substantial losses by utility affiliates must ultimately result in harm to utility rate-payers by raising the cost of capital of the holding company. The State commissions have a limited ability to protect rate-payers where this is the case.
- Some promoting PUHCA repeal rely in part on the fact that the FERC requires utilities to keep their accounts according to the uniform system of accounts. However, the FERC waives this requirement for utilities selling only at market-based rates.
- Those promoting PUHCA repeal also rely on the fact that the FERC reviews wholesale rates. However, in reviewing wholesale rates, the FERC is increasingly relying on the negotiations among the utilities and their customers in order to establish market-based rates. If multi-state holding companies are allowed to own utilities as well as power marketers and service companies across the country, rate negotiations among utilities may become increasingly a matter of affiliate self-dealing, directly or indirectly.
- Moreover, the huge holding companies that are likely to result if PUHCA is repealed may be able to quickly eliminate any real competition from smaller companies as a result of their sheer size. Thus, the "market" in which the FERC intends to rely to set just and reasonable rates may soon well be the product of utility self-dealing within an oligopoly.
- There is very little that has changed in terms of the risk of foreign utility investments since 1935, *i.e.*, foreign utility investments are still extremely risky. In May 1996, the trade press recounted three different instances where the bills for electric power from U.S.-owned power facilities in foreign countries have simply not been paid.
- PUHCA has safeguards that ensure that captive utility customers will not subsidize these risky investments. If PUHCA is removed, the States may well lack control over multi-state utility holding company affiliates under the Commerce Clause of the U.S. Constitution and find themselves unable to prevent such risky foreign investments by utility affiliates from harming captive customers.

105TH CONGRESS
1ST SESSION

S. 621

To repeal the Public Utility Holding Company Act of 1935, to enact the Public Utility Holding Company Act of 1997, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 22, 1997

Mr. D'AMATO (for himself, Mr. MURKOWSKI, Mr. DODD, Mr. SARBANES, Mr. GRAMM, Mr. SHELBY, Mr. MACK, Mr. FAIRCLOTH, Mr. ALLARD, Mr. LOTT, Mr. DOMENICI, Mr. AKAKA, Mr. INOUE, Mr. COATS, Mr. COCHRAN, Mr. ROBERTS, Mr. BROWNBACK, Mr. COVERDELL, Mr. SPECTER, and Mr. NICKLES) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To repeal the Public Utility Holding Company Act of 1935, to enact the Public Utility Holding Company Act of 1997, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Public Utility Holding
5 Company Act of 1997".

6 **SEC. 2. FINDINGS AND PURPOSES.**

7 (a) **FINDINGS.**—The Congress finds that—

1 (1) the Public Utility Holding Company Act of
2 1935 was intended to facilitate the work of Federal
3 and State regulators by placing certain constraints
4 on the activities of holding company systems;

5 (2) developments since 1935, including changes
6 in other regulation and in the electric and gas indus-
7 tries, have called into question the continued rel-
8 evance of the model of regulation established by that
9 Act;

10 (3) there is a continuing need for limited Fed-
11 eral and State regulation in order to ensure the rate
12 protection of utility customers; and

13 (4) limited Federal regulation is necessary to
14 supplement the work of State commissions for the
15 continued rate protection of electric and gas utility
16 customers.

17 (b) PURPOSES.—The purposes of this Act are—

18 (1) to eliminate unnecessary regulation, yet
19 continue to provide for consumer protection by facili-
20 tating existing rate regulatory authority through im-
21 proved Federal and State commission access to
22 books and records of all companies in a holding com-
23 pany system, to the extent that such information is
24 relevant to rates paid by utility customers, while af-

1 fording companies the flexibility required to compete
2 in the energy markets; and

3 (2) to address protection of electric and gas
4 utility customers by providing for Federal and State
5 access to books and records of all companies in a
6 holding company system that are relevant to utility
7 rates.

8 **SEC. 2. DEFINITIONS.**

9 For purposes of this Act—

10 (1) the term “affiliate” of a company means
11 any company 5 percent or more of the outstanding
12 voting securities of which are owned, controlled, or
13 held with power to vote, directly or indirectly, by
14 such company;

15 (2) the term “associate company” of a company
16 means any company in the same holding company
17 system with such company;

18 (3) the term “Commission” means the Federal
19 Energy Regulatory Commission;

20 (4) the term “company” means a corporation,
21 partnership, association, joint stock company, busi-
22 ness trust, or any organized group of persons,
23 whether incorporated or not, or a receiver, trustee,
24 or other liquidating agent of any of the foregoing;

1 (5) the term "electric utility company" means
2 any company that owns or operates facilities used
3 for the generation, transmission, or distribution of
4 electric energy for sale;

5 (6) the terms "exempt wholesale generator"
6 and "foreign utility company" have the same mean-
7 ings as in sections 32 and 33, respectively, of the
8 Public Utility Holding Company Act of 1935, as
9 those sections existed on the day before the effective
10 date of this Act;

11 (7) the term "gas utility company" means any
12 company that owns or operates facilities used for
13 distribution at retail (other than the distribution
14 only in enclosed portable containers or distribution
15 to tenants or employees of the company operating
16 such facilities for their own use and not for resale)
17 of natural or manufactured gas for heat, light, or
18 power;

19 (8) the term "holding company" means—

20 (A) any company that directly or indirectly
21 owns, controls, or holds, with power to vote, 10
22 percent or more of the outstanding voting secu-
23 rities of a public utility company or of a holding
24 company of any public utility company; and

1 (B) any person, determined by the Com-
2 mission, after notice and opportunity for hear-
3 ing, to exercise directly or indirectly (either
4 alone or pursuant to an arrangement or under-
5 standing with one or more persons) such a con-
6 trolling influence over the management or poli-
7 cies of any public utility company or holding
8 company as to make it necessary or appropriate
9 for the rate protection of utility customers with
10 respect to rates that such person be subject to
11 the obligations, duties, and liabilities imposed
12 by this Act upon holding companies;

13 (9) the term "holding company system" means
14 a holding company, together with its subsidiary com-
15 panies;

16 (10) the term "jurisdictional rates" means
17 rates established by the Commission for the trans-
18 mission of electric energy in interstate commerce,
19 the sale of electric energy at wholesale in interstate
20 commerce, the transportation of natural gas in inter-
21 state commerce, and the sale in interstate commerce
22 of natural gas for resale for ultimate public con-
23 sumption for domestic, commercial, industrial, or
24 any other use;

1 (11) the term "natural gas company" means a
2 person engaged in the transportation of natural gas
3 in interstate commerce or the sale of such gas in
4 interstate commerce for resale;

5 (12) the term "person" means an individual or
6 company;

7 (13) the term "public utility" means any person
8 who owns or operates facilities used for transmission
9 of electric energy in interstate commerce or sales of
10 electric energy at wholesale in interstate commerce;

11 (14) the term "public utility company" means
12 an electric utility company or a gas utility company;

13 (15) the term "State commission" means any
14 commission, board, agency, or officer, by whatever
15 name designated, of a State, municipality, or other
16 political subdivision of a State that, under the laws
17 of such State, has jurisdiction to regulate public util-
18 ity companies;

19 (16) the term "subsidiary company" of a hold-
20 ing company means—

21 (A) any company, 10 percent or more of
22 the outstanding voting securities of which are
23 directly or indirectly owned, controlled, or held
24 with power to vote, by such holding company;
25 and

1 (B) any person, the management or poli-
2 cies of which the Commission, after notice and
3 opportunity for hearing, determines to be sub-
4 ject to a controlling influence, directly or indi-
5 rectly, by such holding company (either alone or
6 pursuant to an arrangement or understanding
7 with one or more other persons) so as to make
8 it necessary for the rate protection of utility
9 customers with respect to rates that such per-
10 son be subject to the obligations, duties, and li-
11 abilities imposed by this Act upon subsidiary
12 companies of holding companies; and

13 (17) the term "voting security" means any se-
14 curity presently entitling the owner or holder thereof
15 to vote in the direction or management of the affairs
16 of a company.

17 **SEC. 4. REPEAL OF THE PUBLIC UTILITY HOLDING COM-**
18 **PANY ACT OF 1935.**

19 The Public Utility Holding Company Act of 1935 (15
20 U.S.C. 79a et seq.) is repealed, effective 18 months after
21 the date of enactment of this Act.

22 **SEC. 5. FEDERAL ACCESS TO BOOKS AND RECORDS.**

23 (a) **IN GENERAL.**—Each holding company and each
24 associate company thereof shall maintain, and shall make
25 available to the Commission, such books, accounts, memo-

1 randa, and other records as the Commission deems to be
2 relevant to costs incurred by a public utility or natural
3 gas company that is an associate company of such holding
4 company and necessary or appropriate for the protection
5 of utility customers with respect to jurisdictional rates for
6 the transmission of electric energy in interstate commerce,
7 the sale of electric energy at wholesale in interstate com-
8 merce, the transportation of natural gas in interstate com-
9 merce, and the sale in interstate commerce of natural gas
10 for resale for ultimate public consumption for domestic,
11 commercial, industrial, or any other use.

12 (b) **AFFILIATE COMPANIES.**—Each affiliate of a hold-
13 ing company or of any subsidiary company of a holding
14 company shall maintain, and make available to the Com-
15 mission, such books, accounts, memoranda, and other
16 records with respect to any transaction with another affli-
17 ate, as the Commission deems to be relevant to costs in-
18 curred by a public utility or natural gas company that is
19 an associate company of such holding company and nec-
20 essary or appropriate for the protection of utility cus-
21 tomers with respect to jurisdictional rates.

22 (c) **HOLDING COMPANY SYSTEMS.**—The Commission
23 may examine the books, accounts, memoranda, and other
24 records of any company in a holding company system, or
25 any affiliate thereof, as the Commission deems to be rel-

1 evant to costs incurred by a public utility or natural gas
2 company within such holding company system and nec-
3 essary or appropriate for the protection of utility cus-
4 tomers with respect to jurisdictional rates.

5 (d) **CONFIDENTIALITY.**—No member, officer, or em-
6 ployee of the Commission shall divulge any fact or infor-
7 mation that may come to his or her knowledge during the
8 course of examination of books, accounts, memoranda, or
9 other records as provided in this section, except as may
10 be directed by the Commission or by a court of competent
11 jurisdiction.

12 **SEC. 6. STATE ACCESS TO BOOKS AND RECORDS.**

13 (a) **IN GENERAL.**—Upon the written request of a
14 State commission having jurisdiction to regulate a public
15 utility company in a holding company system, and subject
16 to such terms and conditions as may be necessary and ap-
17 propriate to safeguard against unwarranted disclosure to
18 the public of any trade secrets or sensitive commercial in-
19 formation, a holding company or its associate company or
20 affiliate thereof, wherever located, shall produce for in-
21 spection books, accounts, memoranda, and other records
22 that—

23 (1) have been identified in reasonable detail in
24 a proceeding before the State commission;

1 (2) the State commission deems are relevant to
2 costs incurred by such public utility company; and

3 (3) are necessary for the effective discharge of
4 the responsibilities of the State commission with re-
5 spect to such proceeding.

6 (b) **EFFECT ON STATE LAW.**—Nothing in this section
7 shall preempt applicable State law concerning the provi-
8 sion of books, records, or any other information, or in any
9 way limit the rights of any State to obtain books, records,
10 or any other information under Federal law, contract, or
11 otherwise.

12 (c) **COURT JURISDICTION.**—Any United States dis-
13 trict court located in the State in which the State commis-
14 sion referred to in subsection (a) is located shall have ju-
15 risdiction to enforce compliance with this section.

16 **SEC. 7. EXEMPTION AUTHORITY.**

17 (a) **RULEMAKING.**—Not later than 90 days after the
18 date of enactment of this Act, the Commission shall pro-
19 mulgate a final rule to exempt from the requirements of
20 section 5 any person that is a holding company, solely with
21 respect to one or more—

22 (1) qualifying facilities under the Public Utility
23 Regulatory Policies Act of 1978;

24 (2) exempt wholesale generators; or

25 (3) foreign utility companies.

1 (b) OTHER AUTHORITY.—If, upon application or
2 upon its own motion, the Commission finds that the books,
3 records, accounts, memoranda, and other records of any
4 person are not relevant to the jurisdictional rates of a pub-
5 lic utility company, or if the Commission finds that any
6 class of transactions is not relevant to the jurisdictional
7 rates of a public utility company, the Commission shall
8 exempt such person or transaction from the requirements
9 of section 5.

10 **SEC. 8. AFFILIATE TRANSACTIONS.**

11 Nothing in this Act shall preclude the Commission
12 or a State commission from exercising its jurisdiction
13 under otherwise applicable law to determine whether a
14 public utility company may recover in rates any costs of
15 an activity performed by an associate company, or any
16 costs of goods or services acquired by such public utility
17 company from an associate company.

18 **SEC. 9. APPLICABILITY.**

19 No provision of this Act shall apply to, or be deemed
20 to include—

- 21 (1) the United States;
22 (2) a State or any political subdivision of a
23 State;
24 (3) any foreign governmental authority not op-
25 erating in the United States;

1 (4) any agency, authority, or instrumentality of
2 any entity referred to in paragraph (1), (2), or (3);
3 or
4 (5) any officer, agent, or employee of any entity
5 referred to in paragraph (1), (2), or (3) acting as
6 such in the course of his or her official duty.

7 **SEC. 10. EFFECT ON OTHER REGULATIONS.**

8 Nothing in this Act precludes the Commission or a
9 State commission from exercising its jurisdiction under
10 otherwise applicable law to protect utility customers.

11 **SEC. 11. ENFORCEMENT.**

12 The Commission shall have the same powers as set
13 forth in sections 306 through 317 of the Federal Power
14 Act (16 U.S.C. 825d–825p) to enforce the provisions of
15 this Act.

16 **SEC. 12. SAVINGS PROVISIONS.**

17 (a) **IN GENERAL.**—Nothing in this Act prohibits a
18 person from engaging in or continuing to engage in activi-
19 ties or transactions in which it is legally engaged or au-
20 thorized to engage on the effective date of this Act, if that
21 person continues to comply with the terms of any such
22 authorization, whether by rule or by order.

23 (b) **EFFECT ON OTHER COMMISSION AUTHORITY.**—
24 Nothing in this Act limits the authority of the Commission
25 under the Federal Power Act (16 U.S.C. 791a et seq.)

1 (including section 301 of that Act) or the Natural Gas
2 Act (15 U.S.C. 717 et seq.) (including section 8 of that
3 Act).

4 **SEC. 13. IMPLEMENTATION.**

5 Not later than 18 months after the date of enactment
6 of this Act, the Commission shall—

7 (1) promulgate such regulations as may be nec-
8 essary or appropriate to implement this Act; and

9 (2) submit to the Congress detailed rec-
10 ommendations on technical and conforming amend-
11 ments to Federal law necessary to carry out this Act
12 and the amendments made by this Act.

13 **SEC. 14. TRANSFER OF RESOURCES.**

14 All books and records that relate primarily to the
15 functions transferred to the Commission under this Act
16 shall be transferred from the Securities and Exchange
17 Commission to the Commission.

18 **SEC. 15. EFFECTIVE DATE.**

19 This Act shall take effect 18 months after the date
20 of enactment of this Act.

21 **SEC. 16. AUTHORIZATION OF APPROPRIATIONS.**

22 There are authorized to be appropriated such funds
23 as may be necessary to carry out this Act.

1 **SEC. 17. CONFORMING AMENDMENT TO THE FEDERAL**
2 **POWER ACT.**

3 Section 318 of the Federal Power Act (16 U.S.C.
4 825q) is repealed.

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